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Fiscal policy and integrated development

Federico J. Herschel *

The aim of the present article is to offer an overall picture of the relation between fiscal policy and economic development in Latin America during the last few decades, combining a description of policy proposals with a critical evaluation of their orientations and results and presenting suggestions for action. It begins by demarcating the actual content of fiscal policy and depicting the more general features of recent economic development, and goes on to analyse on this basis, critically and in detail, the proposals for tax reforms arising out of the conferences on fiscal policy held between 1961 and 1972 in Buenos Aires, Santiago, Chile, and Mexico City. Although a significant and cumulative contribution has been made by each and all of them to the development of fiscal policy in Latin America, their recommendations are open to some objections, to the effect, for instance, that they obscure the importance of public expenditure and disregard political questions.

After rapidly reviewing the relation between fiscal policy and development in the light of events in some of the developed countries, the author concentrates his attention on the analysis of the results achieved by fiscal policy in respect of redistribution and investment. Lastly, he puts forward his own fiscal policy proposal, which is oriented more towards redistribution than towards private investment incentives, and appraises its probable political viability.

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1. The concept of fiscal policy and its objectives. Fiscal reform

Surprising though it may seem to some, and to others, on the contrary, almost too obvious to mention, a necessary first step is to indicate the concept of fiscal policy which will be used in this study. Fiscal policy is interpreted here as the use of the instruments constituting the budget, in a broad sense which comprises not only taxes but also expenditure, financing of public enterprises, management of the public debt and financing of the deficit in order to attain the government's objectives.

Such a concept is different from that prevailing in the treatises which have appeared in the Anglo-Saxon countries, or in French studies. In the former, fiscal policy is seen as the use of public finance instruments purely for stabilization purposes, although growth is sometimes included, but always viewed globally;¹ in the latter, fiscal questions are associated exclusively with the tax field.

¹ See, for example, the following works: Richard A. Musgrave, *The Theory of Public Finance*, New York, McGraw Hill, 1959, in which the author considers fiscal policy in the context of compensatory finance, and thus defines it as measures which involve tax or public expenditure action but do not alter the structure of the financial liabilities (p. 528); John F. Due, *Government Finance: Economics of the Public Sector*, Homewood, Illinois, R.D. Irwin, Inc., 1968, where the definition given is that the term fiscal policy (or stabilization and growth policy) refers to adjustments in government expenditure and income in order to achieve greater economic stability (p. 207); Charles M. Allan, *The Theory of Taxation*, Harmondsworth, Middlesex, Penguin Books, 1971, p. 187; Alan S. Blinder and Robert

Since policy consists, as already stated, in the use of a number of government instruments for achieving certain official aims², it forms part of economic policy; and the aims of both are therefore identical. The fact that all economic policy instruments pursue the same ends does not mean that some instruments are not more efficient than others for specific purposes. In a situation of extreme necessity, such as that of a city under siege, even a liberal economist like Lord Robbins admits that rationing would have to be adopted. In normal times, national defence is basically undertaken by means of public expenditure, except in the case of military conscription; monetary and credit policy can play only a subsidiary role in this area.

In line with this view, the same relationship exists between fiscal policy and finance as between economic policy and economic theory.

The instrumental nature of the means used and the possibility of differences in their efficacy should not hurry us into two erroneous conclusions:

M. Solow, "Analytical Foundation of Fiscal Policy", *The Economics of Public Finance*, Washington, The Brookings Institution, 1974, p. 4. A similar approach to that adopted in the present study may be found in Victor L. Urquidí, "La política fiscal en el desarrollo económico de América Latina", *Ensayos de Política Fiscal* (ed. H. Assael), pp. 46-53; David T. Geithman, "Fiscal Policy in Latin America: An Overview", *Fiscal Policy for Industrialization and Development in Latin America*, compiled by D.T. Geithman, The University of Florida Press, 1974, p. 1; and *Fiscal Policy for Economic Growth in Latin America*, papers and proceedings of a conference held in Santiago, Chile, December 1962 (organized by the OAS/IDB/CEPAL Joint Tax Program), Baltimore, The Johns Hopkins Press, 1965.

²E.S. Kirschen *et al.*, *Economic Policy in Our Time*, Amsterdam, North Holland Publishing Co., 1964, vol. 1, p.3.

(a) Their essentially instrumental character does not mean that the distinction between instruments and objectives is absolutely rigid. In Germany, for example, economic neo-liberalism distinguishes between instruments consistent and not consistent with a market economy and in principle rejects the latter—for example, all State interventionism, welfare-State employment programmes, and in general any kind of State control. Without going to these extremes, it is by no means surprising that certain instruments should be repudiated, as, for example, drastic changes, classed by Kirschen as institutional changes, which directly affect production conditions (land reform, the extension of public ownership).³ Therefore, it is neither desirable nor appropriate to talk about the ateleological nature of a tax system, even were it conceived only as a conceptual model. In the fiscal area too there are some instruments (for example, the fiscal deficit or the tax on capital) which are opposed more for ideological reasons or preconceptions than because of an analysis of their effectiveness. One may disagree entirely with this attitude, but it is a reality which must be taken into account;

(b) Since instruments do not produce one result only but have repercussions in different areas and affect different objectives, it is likewise a mistake in their case to apply a kind of division of labour, assigning to monetary policy, for instance, the stabilization objective and to fiscal policy the aim of development,⁴ since fiscal policy is capable of influencing not merely development but

³*Ibid.*, pp. 17 and 135-143.

⁴ILPES, *Discusiones sobre programación monetario-financiera*, Mexico City, Siglo XXI, 1972.

income distribution and stabilization as well. It may also be of advantage to use more than one instrument to attain a single goal. In short, all economic policy instruments should converge to achieve the set of objectives that make up government strategy.

Although they pertain to economic policy, fiscal instruments do not operate in the limited abstract world of *homo oeconomicus*; on the contrary, they are immersed in the realities of politics and of the power structure, and a concept which concerns itself only with economic aspects may often, either consciously or unconsciously, be prompted in fact by a specific line of policy or power group.⁵

It should be clearly understood from the outset that this study visualizes fiscal reform⁶ as a substantive transformation of the existing fiscal system. In order to determine the needs which have to be taken into account by such a reform, a brief diagnosis will be made of the most important aspects of the economic and social situation.

To undertake a genuine reform, such as is contemplated here, what is first of all needed is a firm determination to carry

it out, and above all, the political possibility of doing so, duly allowing for the power factors. With this in mind, in addition to the aforesaid diagnosis it would seem necessary to analyse certain salient features of fiscal reform efforts made in Latin America over the past 15 years, and to evaluate their results. It is of fundamental importance to determine the real possibilities or probabilities of a fiscal system's attaining the economic and social objectives defined later in this article. In other words, the aim is to determine the effectiveness of the instruments available in the fiscal area, to which end the experience of developed countries and the theoretical contributions relevant to the purpose of the present study will be briefly analysed. Some references will also be made to the socio-political circumstances required for putting the reforms into practice.

To clarify the concept of fiscal reform, the basic assumption adopted here is that it is capable in present conditions of operating within the existing system and modifying or helping to modify the prevailing style;⁷ but in the event of a change in the system it would play only a partial or supplementary role.⁸

⁵See *Power In Economics* (ed. K.W. Rothschild), Harmondsworth, Penguin Books, 1971, in particular the "Introduction" by K. W. Rothschild, and the article by E. Ronald Walker, "Beyond the market".

⁶For a more comprehensive treatment of the concept of fiscal reform, see F.J. Herschel, *Ensayos sobre política fiscal*, Madrid, Editorial de Derecho Financiero, 1975, pp. 491-498.

⁷See, in this connexion, Aníbal Pinto, "Styles of development in Latin America", *CEPAL Review* N° 1, first half of 1976, United Nations publication, Sales N°: E.76.II.G.2, p. 102.

⁸See, in this context, the reference to the application of a special tax on capital during the civil war in the USSR, and the use of income and property taxes in the NEP period to finance economic and cultural development, in *Soviet Financial System*, Moscow, Progress Publishers, 1966, pp. 78-80.

2.

Diagnosis of the present situation

In contrast with the optimism created by the potentialities of economic development in past periods, considerable frustration is now being felt when the results achieved by economic development in Latin America are examined.⁹ This evaluation has been clearly and concisely summarized by Raúl Prebisch in the first issue of the *Review*.

(a) Development tends to by-pass a large part of the population. It is primarily restricted to the upper income strata, where the consumption patterns of the industrialized centres are imitated to an ever-increasing extent. The consumer society has thus established itself in the peripheral countries, and the middle income strata, seduced by its allurements, are striving to participate in it, and are succeeding. All this is in sharp and glaring contrast with the society of infra-consumption in which the lower strata of the social structure struggle to subsist;

(b) Despite these limitations, and accompanying the structural changes in the economic area, a phenomenon of major importance supervenes. The growth of democratic power in the middle strata and its extension to the lower strata—however limited it may be—results in a steadily widening gap between the eco-

nomie process and the political process;

(c) Advancing democratization demands a sharp rise in the rate of capital accumulation and a modification of the distribution system;

(d) Peripheral capitalism is inclined, by and large, to sacrifice democratization in one way or another for the sake of defending and promoting the consumer society.¹⁰

As regards paragraph (a), it must be borne in mind that unequal income distribution means sickness, premature death, illiteracy, over-crowding and under-nutrition. Any comparative reports by international agencies will bear out the truth of this statement, if it is not already obvious in the streets and dwellings, in the schools and hospitals.

This kind of evaluation, particularly as regards economic development in the strict sense, is of course not endorsed by the groups benefiting from the advances made.¹¹

¹⁰ See "A critique of peripheral capitalism", *CEPAL Review*, N° 1, first half of 1976, *op. cit.*, pp. 7 and 52-57.

¹¹ See Marshall Wolfe, CEPAL, *El desarrollo esquivo: Exploraciones en la política social y la realidad sociopolítica*, Mexico City, Fondo de Cultura Económica, 1976, p. 22. An exclusive pursuit of economic growth calls for an exceptional combination of strength and continuity in the political system, with an adequate supply of resources and a favourable international situation. In the few cases where these requisites have been present, the exclusive pursuit of economic growth has not been counter-productive in its own terms, nor in terms of the interests of the groups controlling the process, albeit the results are open to criticism from the

⁹ See also CEPAL, *Long-term Trends and Projections of Latin American Economic Development* (E/CEPAL/1027), 3 March 1977, p. 2. In the development process a relatively high economic growth rate has been persistently accompanied by a distribution of income and property which has failed to evolve favourably for the less privileged groups representing at least half the population.

With respect to paragraphs (c) and (d) of the analysis by Raúl Prebisch mentioned above, it should be noted that, in so far as the options derive from value judgements, those constituting the basic approach to the present study need to be brought into focus.

The basic hypothesis is that in the long run the democratization process will continue, and this involves raising the rate of capital accumulation and modifying the distribution system (paragraph (c)). Although at the present time it does not appear to represent the prevailing style, this hypothesis is nevertheless believed to be the right one, for while the approaches adopted need to be in firm touch with reality, the kind of false realism which assumes what exists and is dominant today to be permanent, and visualizes the future as a mere extrapolation of the present, is rejected here. On the contrary, the present is viewed in terms not only of itself and of the past, but also of the future. To grasp and achieve what is real and what is possible, it is necessary to include a component of what is today apparently utopian and impossible, but will be possible tomorrow.¹²

A second postulate is the need for an integrated development process in which it is at once viable and desirable to advance towards all the desired goals.¹³ It may probably be difficult to attain the

standpoint of human well-being and the values of equity, and although, furthermore, it is doubtful whether the resulting tensions will prove manageable over the long term.

¹² Marcos Kaplan, *Teoría política y realidad latinoamericana*, Archives of the Fondo de Cultura Económica, Mexico City, 1976, p. 64.

¹³ *Report on a unified approach to development analysis and planning, Preliminary report of the Secretary-General, October 1973, cited in El desarrollo esquivo, op. cit., p. 41.*

objectives of economic development and social development (or, as Raúl Prebisch puts it, accumulation and redistribution), simultaneously and at all times, so that it would be preferable to aim at achieving them over the medium and the long term.

Hence it becomes necessary to indicate short-term priorities, with primary attention to redistribution and, above all, the elimination of critical poverty.¹⁴

Lastly, it should be noted that, even on the most optimistic assumption, the achievement of the objectives listed will require a particular combination of socio-political forces.

Once the basic premises have been established, their implications for fiscal policy must be clarified.

There is a very wide field of action for public expenditure policy,¹⁵ which should be financed basically by a progressive tax system to ensure that the social classes which are intended to benefit from greater social expenditure will not end up having to pay for it. Of course, the required economic development objectives would not be neglected, i.e., structural change, capital formation on a larger scale, improvement of

The objectives stated are: accelerated growth, structural changes, a more equitable distribution of income and wealth, the expansion of social services and protection of the environment (*ibid.*).

¹⁴ See the relevant projections given in Aníbal Pinto, "Styles of development in Latin America", *op. cit.*, pp. 127 and 128. By the year 2000 the primitive or subsistence stratum would disappear and a very high level of homogeneity and modernization would be achieved. According to another projection, there would only be a sharp reduction in that stratum.

¹⁵ See *Long-term Trends and Projections...*, *op. cit.*, p. 7.

the educational levels of human resources, wider national participation in technological innovations, etc.

This option, despite all the problems that are bound to arise, would be more feasible if democratic progress in favour of redistribution could be channelled into fiscal measures.¹⁶

Although from the next section onwards reference will be made only to the above-mentioned option, it is useful to indicate the trends observable at present. The problem of the disparity between the political and the economic process tends to be solved, with some exceptions, by abandoning democratic systems of government, a step which results in the following trends as regards fiscal action:

(i) The economic power groups will exert increasing pressure against any attempt at income redistribution;

(ii) The break-down of the political process is conducive to a deterioration of the situation of the low-income groups, as has been demonstrated in more than one Latin American country.

Thus the gap between needs and possibilities of meeting them widens increasingly; and this is in essence the basic problem of fiscal policy. It is, of course,

¹⁶ In this respect, the somewhat unfortunate experience of redistributive policy through wage increases should not be forgotten. See Ricardo French-Davis, "Mecanismos y objetivos de la redistribución del ingreso", *Distribución del ingreso* (ed. Alejandro Foxley), Mexico City, Fondo de Cultura Económica, 1974.

part of the problem of under-development, but it takes on an essentially fiscal character when, on the one hand, economic development needs (basic infrastructure, energy, transport and communications), the requirements of the power groups, or a modicum of satisfaction of social demands call for an increase in expenditure, while on the other hand the opposition to any additional taxation that may affect the economic power groups is exceedingly strong. Hence the fiscal crisis, which generally leads to financing by means of currency issues or external borrowing.

Thus, to give a few figures, within a decade (1960-1961 to 1969-1970) total public expenditure in Latin America as a whole (weighted average) climbed from 20.7 per cent to 25.7 per cent of the gross domestic product, while taxes were raised from 14.4 to 17.2 per cent. Concurrently, there was an impressive increase in the external public debt, from 5 108 million dollars at the beginning of 1960 to 15 389 million at the beginning of 1971.¹⁷

As noted earlier, consideration of the possibilities of fiscal reform should take recent historical experience into account. The following sections of the present study will deal with this subject.

¹⁷ CEPAL, *Latin America and the International Development Strategy: First Regional Appraisal* (E/CN.12/947), 5 February 1973, p. 184.

3.

The first conferences of the Joint Tax Program. Conferences in Buenos Aires and Santiago, Chile

There had been interesting previous attempts to advocate changes in the fiscal system in relation to economic development needs,¹⁸ but an overall and more integrated approach emerged from the Declaration of Punta del Este, in which the 21 countries of Latin America undertook to reform their tax laws, demand more from those who have more, severely penalize tax evasion, and redistribute the national income to benefit the neediest, while at the same time promoting saving and the investment and reinvestment of capital.¹⁹

The joint Tax Program, originally established by OAS, IDB and CEPAL, held its first conference on tax administration in Buenos Aires in 1961.

Obviously, the efficient implementation of tax policy requires the proper operation of the bodies concerned with the collection and control of the taxes which flow or should flow into the Treas-

ury. Thus, it is important to stress the negative significance of the complexity, multiplicity and dispersion of tax laws, the inadequacy of the accounting registers and the lack of proper training for tax officials.²⁰ Although it is outside the scope of this study to go further into essentially administrative topics, two subjects discussed at the conference are worth special mention:

(1) The calculation of the distribution of the tax burden; and

(2) Prevention of income tax evasion.

In connexion with the latter subject, as might be expected, strong emphasis was laid on the legal and administrative aspects of the fight against evasion, which of course is not surprising in view of the nature of the conference. Nor would it be fair to deny the importance of adequate penalties and suitable detection mechanisms among the measures required to combat evasion.

Valuable as were the discussions on this subject, the following critical observations would seem relevant, not as a facile product of mere hindsight but, on the contrary, because such progress as has admittedly been made since then is

¹⁸ See John H. Adler, E.R. Schlesinger and E.C. Olson, *Public Finance and Economic Development in Guatemala*, Stanford University Press, 1952; *Taxes and Fiscal Policies in Under-Developed Countries*, United Nations publication, Sales N°: 1955.II. H.1; Carl Shoup *et al.*, *The Fiscal System of Venezuela - A Report*, Baltimore, 1950; Henry C. Wallich and John H. Adler, *Proyecciones económicas de las finanzas públicas: un estudio experimental en El Salvador*, Mexico City, Fondo de Cultura Económica, 1951.

¹⁹ Quoted in Richard M. Bird and Oliver Oldman, "Tax research and tax reform in Latin America - A survey and commentary", *Latin American Research Review*, vol. III, N° 3, Summer 1968, pp. 5-23.

²⁰ Address by Mr. Manuel Rapoport, Director-General, Internal Revenue Administration, at the closing meeting on 19 October 1961. See *Problems of Tax Administration in Latin America*, papers and proceedings of a Conference held in Buenos Aires, Argentina, in October 1961, Baltimore, The John Hopkins Press, 1965, pp. 548-555.

far from having radically altered the situation prevailing at the time:

(i) Evasion does not occur only in income tax. Some of the few existing studies show that although it is found on the largest scale in personal income tax, in the case of other taxes it is by no means insignificant; it was estimated that there was considerable evasion of social security contributions in Argentina²¹ and of sales tax in Chile;

(ii) Incidental reference was made to an empirical study undertaken by the United States. Fifteen years later, the quantitative estimates prepared in Latin America are still few in number; not even the developed countries, except for one or two like the United States and Canada, make frequent quantitative assessments, and furthermore, no standard methodology is followed, which makes comparisons between countries difficult;

(iii) Avoidance of tax (or legal evasion, as it is also called) was hardly mentioned. To generalize on the basis of an observation made for two countries in particular,²² it would seem reasonable to affirm that outright tax evasion is usually greater in countries in process of development, while avoidance is more prevalent in developed countries.²³ If this hypothesis is confirmed, however, it should not be concluded that avoidance

²¹ See F.J. Herschel, *Ensayos . . . op. cit.*, pp. 256-274.

²² Namely, the United Kingdom and Israel (see A. Lapidoth, *Evasion and Avoidance of Income Tax*, Jerusalem, State Revenue Administration, 1966, pp. 13, 200-201).

²³ The following reasons may account for the difference: the rich countries have more large-scale enterprises which can afford tax advisers, while it may also be assumed that as a country develops, its laws too become increasingly complex, and this often facilitates tax avoidance.

—particularly if the term is interpreted in a broad sense— is not important. Quite the contrary: it appears in different forms and under different names, but is always aimed at reducing the tax burden, most frequently for the upper income groups;

(iv) The causes of evasion were not examined very thoroughly. In this field at least it is possible to point to some progress in the developed countries, as regards both analysis and empirical studies,²⁴ but analyses of this kind are practically non-existent in Latin America;

(v) Neither evasion proper nor avoidance occur in an isolated setting in which the defenceless taxpayer faces up to the tax-collecting ogre, nor are all the defects or shortcomings such as administrative and legal inadequacy and lack of entrepreneurial capacity or of trained technical specialists imputable to underdevelopment; here too it is the groups in power which are active and make use of such procedures to reduce their share of the tax burden.

The study of the distribution of the tax burden is related with one of the

²⁴ See, for the conceptual approaches, T.N. Srinivasan, "Tax evasion: a model", *Journal of Public Economics*, vol. 2, N° 4, November 1973; and for those of an empirical character, Joachim Vogel, "Taxation and public opinion in Sweden: an interpretation of recent survey data", *National Tax Journal*, vol. XXVII, N° 4, December 1974. In the first study, evasion is explained as resulting from a comparison made by the potential taxpayer between the cost of paying the tax on the one hand and the sum he would have to pay if he were discovered, weighted by the possibility of detection. The second study examines the reasons for tax evasion in Sweden on the basis of surveys, adducing the effects of the environment in which the possible tax evader is acting (influence of friends, colleagues, etc.), the complexity of the tax laws and the very high tax rates prevailing.

basic aims of fiscal policy —improvement of the distribution of income— and attempts to determine how far this objective is actually being achieved. In view of the importance of this question a special section will be devoted to it, with the further justification afforded by the significant advances made in this field. At this stage, however, none but the following points are worth mentioning:

(a) Prior to the Buenos Aires Conference, somewhat rough estimates of the distribution of the tax burden were prepared for only two Latin American countries;²⁵

(b) Since the conference was concerned with tax problems, the studies on distribution made practically no reference to the possible effect of public expenditure.

The second conference, which was held in Santiago, genuinely represents an important milestone in the evolution of fiscal policy in Latin America. It was attended by representatives of all the Latin American countries except Cuba, as well as by economists not only from Latin America but also from several developed countries. What is most important, however, is that specific conclusions were reached, and it was expressly stated that although the social, political, legal, and administrative characteristics of the various Latin American countries differed, recognition of that fact did not “imply a modifica-

tion of the objectives or a reduction of the required pace or pervasiveness of tax reform”.

As will have been gathered from the preceding sections, and as will become even more evident later, this is an essentially critical study for the following reasons: matters of great significance have frequently been examined somewhat superficially; the tendency has been towards extreme over-simplification; and according to the criterion followed here —that is, the value judgements adopted— too little attention has been paid to the necessity of improving distribution. The Santiago Conference merits a different evaluation, since many of the observations made there deserve full praise: the meetings were not confined to purely conceptual discussions but went as far as preparing a number of recommendations for possible practical implementation —not a very common achievement at a meeting of this kind— and the conclusions come close to forming a genuine plan of action. Moreover, the recommendations were of an essentially progressive nature in both senses of the word, i.e., not only by virtue of a general trend towards social change but also in the specific field of taxation where they advocated greater vertical equity, or, to employ equivalent but more frequently used terms, taxation based on the capacity to pay.²⁶ The following guidelines are particularly noteworthy:

²⁵ See *Public Finance and Economic Development in Guatemala*, *op. cit.*; and Carl S. Shoup, Lyle C. Fitch, Sir Donald MacDougall, Oliver S. Oldman and Stanley S. Surrey, “The Fiscal System of Venezuela — A report”, Baltimore, The John Hopkins Press, 1959. The author of the present study presented a preliminary estimate of the distribution of the tax burden in Argentina for the Buenos Aires Conference; see *Problems of Tax Administration in Latin America*, *op. cit.*, pp. 76-90.

²⁶ See *Fiscal Policy for Economic Growth in Latin America*, *op. cit.*, p. 419. The following is the text of the recommendations: (1) the reform, simplification, and up-dating of the system of indirect taxation; (2) the creation of a comprehensive unitary system of progressive personal income tax, which should include the taxation of capital gains both on movable and on immovable property, complemented by a

(a) The creation of a unitary system of progressive income tax to include the taxation of capital gains, supplemented by a net wealth tax (although the proviso "where feasible" was added);

(b) Higher taxes on urban and rural property;

(c) Strengthening of inheritance and gift taxation; and

(d) The cautious use of incentives.

The question is, therefore, whether these suggestions have been complied with, and if not, an explanation will have to be found for the failure in practice—although not necessarily the complete failure—to achieve objectives so extensively examined and, on the whole, so well conceived.

4.

Changes in tax systems after the Santiago Conference

A thorough examination of each country's tax system lies outside the scope of a study such as this. It would require a special investigation in every case, combining macro- and micro-economic aspects; it would also entail a study of the legislation in its material sense, i.e., covering decrees, regulations and resolutions, and also their effective application

net wealth tax where feasible; (3) the collection of more revenue from taxes on urban and rural property, additional to personal income taxes on the income derived from such property, and co-ordinated with other forms of special taxation on income from property; (4) the strengthening of the system of inheritance and gift taxation; (5) the placing of public enterprises on a self-sustaining basis through the adoption of adequate rates for services rendered; (6) the harmonization of the tax treatment of the income of international enterprises and the imposition of taxes on the income which residents receive from abroad; (7) the creation of a fiscal climate which, with the cautious use of incentives, will be attractive to the formation of private capital and its investment in productive enterprise; (8) the reform of budgetary practices and the inclusion in budgets of the operating results of autonomous or semi-public agencies; (9) the establishment of an objective and co-ordinated system of tax administration,

and implementation; it would have to analyse how far tax revenue is sufficient in relation to the possible growth of the public sector's needs, so that it would need to include an analysis of automatic flexibility and reaction capacity;²⁷ and of course it would also comprise a study of the impact of taxation on the private sector and of its implications.

A first overall view shows that the tax effort, in terms of tax revenue as a percentage of the gross domestic product for the region as a whole, has not been very significant, as is clearly seen from table 1. From 1960 to 1972 it grew from

using each tax to give more solidity to the others, so as to guarantee that the benefits of substantial reform will not be lost in administration.

²⁷ Automatic flexibility is understood here to mean the increase in revenue from a tax or group of taxes in relation to the gross domestic product with no changes in the laws (i.e., no changes in rates, deductions, exemptions, etc.) in a given period. Reaction capacity (ex-post-buoyancy flexibility), on the other hand, also considers the increase in revenue from a tax in relation to the product, but with the incorporation of that resulting from legal changes (e.g., an increase in rates).

Table 1
**LATIN AMERICA: TAX REVENUE, 1960 AND
 1970-1973^a**

(As a percentage of the gross domestic product at current prices)

	1960	1970	1971	1972	1973
Argentina	14.0	15.2	13.0	11.2	11.1
Barbados	...	...	...	...	...
Bolivia	7.9	9.2 ^b	8.2 ^b	7.5 ^b	...
Brazil	18.1	20.6	20.5	22.1	22.5
Colombia	9.7	11.8	11.8	11.1	...
Costa Rica	12.1	13.9	13.7	13.8	14.8
Cuba	...	...	...	...	...
Chile	16.5	18.5	18.6	16.8	...
Ecuador ^c	12.3	13.3	15.5	15.9	...
El Salvador ^c	10.9	10.3	10.4	10.6	11.5
Guatemala	8.6	8.3	8.4	8.3	7.9
Guyana	...	...	...	...	...
Haiti ^d	7.8	6.0	6.0	5.9	...
Honduras	10.7	11.9	11.4	11.0	11.6
Jamaica	...	...	...	...	...
Mexico	7.5	8.8	9.0 ^e	9.3	9.6 ^e
Nicaragua	10.4	9.8	10.1	9.9	11.6
Panama	10.1	12.3	12.4	12.0	11.9
Paraguay ^c	8.6 ^f	10.4	9.4	8.3	...
Peru	13.0	15.4	15.0	14.9	14.6
Dominican Republic	16.5	14.8	15.0	14.0	13.0
Trinidad and Tobago	...	...	...	...	...
Uruguay	15.4	17.4	17.6	15.3 ^c	...
Venezuela	12.8	12.6	15.3	14.7	16.4
<i>Latin America^g</i>	<i>13.0</i>	<i>14.3</i>	<i>14.3</i>	<i>14.4</i>	<i>15.0</i>

Source: *Indicators of economic and social development in Latin America* (E/CEPAL/1021), 18 November 1976.

^aExcluding social security contributions.

^bRevenue of treasury and of municipalities of La Paz and Santa Cruz.

^cCentral government only.

^dBudget income.

^eProvisional estimates.

^f1962.

^gExcluding Cuba and the English-speaking Caribbean countries.

Table 2
**LATIN AMERICA: DIRECT TAXES, 1960 AND
 1970-1973**

(As a percentage of total tax revenue)

	1960	1970	1971	1972	1973
Argentina	23.3	22.0	18.1	16.4	18.7
Barbados	...	...	...	...	...
Bolivia	12.7	14.5	21.7	19.0	...
Brazil	20.0	24.4	27.8	31.9	31.9
Colombia	51.4	47.5	45.8	45.5	...
Costa Rica	16.0	23.2	23.9	25.5	...
Cuba	...	...	...	...	...
Chile	38.6	35.1	32.7	29.8	...
Ecuador	14.7	20.9	29.0	28.6	...
El Salvador	12.5	24.6	24.9	24.8	25.6
Guatemala	9.2	17.6	18.3	19.3	...
Guyana	...	...	...	...	...
Haiti	8.8	11.7	10.7	11.9	...
Honduras	17.3	28.5	27.9	25.9	...
Jamaica	...	...	...	...	...
Mexico	34.3	45.8	44.9	46.8	45.2
Nicaragua	12.2	19.4	19.5	20.6	15.5
Panama	32.6	48.1	48.5	44.8	47.5
Paraguay	17.2	17.5	19.3	20.1	...
Peru	38.1	36.0	31.0	35.3	...
Dominican Republic	23.7	30.1	30.2	31.2	31.8
Trinidad and Tobago	...	...	...	...	...
Uruguay	21.4	15.0	13.8	...	...
Venezuela	55.5	70.4	76.1	76.1	81.0
<i>Latin America</i> ^a	29.6	37.6	34.7	36.2	...

Source: *Indicators of economic and social development in Latin America* (E/CEPAL/1021), 18 November 1976.

^aExcluding Cuba and the English-speaking Caribbean countries.

Table 3
**LATIN AMERICA: INDIRECT TAXES, EXCLUDING FOREIGN TRADE TAXES,
 1960 AND 1970-1973**

(As a percentage of total tax revenue)

	1960	1970	1971	1972	1973
Argentina	53.2	65.9	67.6	65.4	63.8
Barbados	...	...	...	...	...
Bolivia	48.5	28.4	33.7	37.2	...
Brazil	75.6	72.5	69.0	64.7	64.7
Colombia	22.8	30.8	33.3	35.0	...
Costa Rica	20.5	42.6	44.8	50.9	...
Cuba	...	...	...	...	...
Chile	41.4	53.0	57.2	60.5	...
Ecuador	38.2	29.4	31.9	33.0	...
El Salvador	25.4	32.4	37.1	36.3	33.9
Guatemala	45.0	53.3	53.1	53.8	...
Guyana	...	...	...	...	...
Haiti	26.8	33.0	33.1	35.5	...
Honduras	31.1	41.7	40.6	42.1	...
Jamaica	...	...	...	...	...
Mexico	43.4	43.4	45.8	44.5	45.5
Nicaragua	31.0	50.6	53.1	52.9	45.7
Panama	18.1	22.6	22.6	22.6	26.5
Paraguay	17.3	36.2	36.0	40.7	...
Peru	39.1	39.4	43.8	43.7	...
Dominican Republic	38.1	21.9	21.1	20.6	17.7
Trinidad and Tobago	...	...	...	...	...
Uruguay	51.3	72.9	74.6	...	...
Venezuela	17.9	18.9	15.3	15.7	12.8
<i>Latin America</i> ^a	49.4	52.6	53.1	51.3	...

Source: *Indicators of economic and social development in Latin America (E/CEPAL/1021)*, 18 November 1976.

^aExcluding Cuba and the English-speaking Caribbean countries.

13 per cent to 14.4 per cent (or by a little over 10 per cent), reaching 15 per cent in 1973 (an increase of less than 20 per cent over the whole period). It should be borne in mind, however, that for the final years 1972-1973 the average for the region was influenced by the upswings in the tax revenue of Venezuela and Ecuador, due in part to the higher income from petroleum; in Brazil too the increase is noteworthy.

As regards the tax structure, in spite of an appreciable rise in the proportion of direct taxes—here again Venezuela's figures affected the total—indirect taxes are still predominant, as may be seen from tables 2 and 3. Thus, for the region as a whole the share of direct taxes is less than 40 per cent, and in none of the countries except Venezuela is it over 50 per cent.²⁸

The following structural factors observed in the tax system of the majority of the countries are also worthy of attention:

(a) The most varied forms of incentives have been intensively granted, often on a very general and indiscriminate basis;

(b) Direct taxes on wages are substantial, and even more so if contributions to the social security systems are included in this group.²⁹ In line with the

²⁸ Needless to say, this classification of taxes as direct and indirect is merely a first approximation, but since the category of direct taxes includes taxes on income and property it is an index, however imperfect, of the progressive character of a system. The degree of significance of this group of taxes also reveals—again as a first approximation—the degree to which development of the system is more advanced, since it makes greater demands on both tax administration and the taxpayer.

²⁹ The inclusion of such contributions in taxes is still a moot question. Cf. Richard M.

criticism adopted in the present study they have been considered as part of tax revenue, because expenditure includes the corresponding payments (services rendered);

(c) Only a few countries have been able to put into effect a genuine global income tax. The existence of bearer shares is one of the obstacles to its introduction;

(d) The agricultural sector's contribution to total revenue is usually rather small. Generally speaking, only export taxes are of any significance, and even then not always on a permanent basis. Over longer periods they are sometimes cancelled out by subsidies granted to the exporters concerned;

(e) Some progress has been made in taxing luxury goods, but on the whole their share in total taxes on goods and services is still small.

Any further evidence seems unnecessary in view of the facts already mentioned.³⁰ It may be interesting, however, to note the opinion of Adolfo Atchabahian, who was for several years Director of the OAS/IDB Joint Tax Program set up precisely for the purpose of carrying out studies to promote reforms in the Latin American countries. In his view, it might have been expected that the mere undertaking of the fiscal studies would be sufficient basis for arousing, in the countries to which they related, concern for change and reform

Bird and Luc Henry de Wulf, "Taxation and income distribution: A critical review of empirical studies", *IMF Staff Papers*, vol. XX, No 3, November 1973, p. 657.

³⁰ Several points coincide with the findings of the study by Richard M. Bird and Oliver Oldman, "Tax research and tax reform in Latin America: A survey and commentary", *op. cit.*, pp. 5-23.

in respect of the shortcomings pointed out in the systems studied. This was far from the case. He felt certain that none of those fiscal studies, in itself and on its own account, had prompted the slightest legislative activity on the countries' part with a view to remedying structural shortcomings in their tax systems that the studies had pointed out. . . . Short-term problems were what had usually spurred the countries to request technical assistance from the Program.³¹

In the face of such a diagnosis, the reason must be sought for this somewhat unfortunate result. The Final Report of the Conference seems to provide a vital key to this question in the following statement: "The participants recognized that the social, political, legal, and administrative characteristics of the various Latin American countries differ and that fiscal reform, to be effectively put into practice, must be consonant with those local characteristics. However, recognition of such considerations does not imply a modification of the objectives or a reduction of the required pace or pervasiveness of tax reform. It is essential, if the goals of accelerated development and improved distribution are to be achieved, that countries overcome, by special efforts, such barriers as may in the past have prevented a comprehensive fiscal reform."³²

There is a contradiction in the paragraph quoted, and more important still, it proposes objectives which are difficult

to achieve within reasonable periods since they are not based on the real situation. The contradiction lies in maintaining, on the one hand, that fiscal reform must be consonant with local characteristics and, on the other hand, that such considerations do not imply a modification of the objectives or a reduction of the required pace or pervasiveness of tax reform.

As regards expenditure, socio-political factors are important in determining levels of illiteracy, infant mortality, malnutrition, etc. Some countries in the world—which obviously need not be enumerated—have shown that they can achieve an improvement in public health and education in spite of being poor countries whose per capita income is below that of virtually all the countries of Latin America. This means that it is not a low level of economic development that basically accounts for social underdevelopment. It is true, therefore, that "resistance by powerful pressure groups blocks the way to effective tax reform", as pointed out by Kaldor, and also hinders any effective social progress by means of augmented public expenditure.

N. Kaldor's study, for its part, provides additional backing when it states that from the standpoint of accelerated economic development the importance of public revenue could hardly be exaggerated. Irrespective of the prevailing ideology or the political colour of particular governments, the economic and cultural development of a country requires the efficient and steadily expanding provision of a whole host of non-revenue-yielding services—education, health, communications systems, etc., commonly known as 'infrastructure'—which require to be financed out of government revenue.³³ This statement is correct, of course, as regards the

³¹ See "La experiencia recogida en el desenvolvimiento del Programa Conjunto de Tributación OEA/BID", *Terceras Jornadas de Finanzas Públicas*, Faculty of Economic Sciences of the National University of Córdoba, Buenos Aires, Ediciones Macchi, S.A., 1971, pp. 209-210.

³² *Fiscal Policy for Economic Growth in Latin America*, *op. cit.*, p. 419.

existence of the needs, but it would be completely false to assume—except in a few cases—that the authorities are actually prepared to satisfy them properly within a reasonable period. In other words, to achieve the provision of educational, health and housing services for the broad masses in the Latin American countries—again with some exceptions—is not a matter independent of the political system or the power structure.

The following is another possible explanation of the scant practical success of the Conference.

Although an interesting study by John Adler³⁴ was examined and some isolated references were made to public expenditure, tax questions appear to have been virtually divorced from expenditure, as is very clear from the final recommendation.³⁵

These two aspects need to be examined together, however, for the following reasons:

(a) From the standpoint of economic development, in the strict sense of

³³ *Fiscal Policy for Economic Growth in Latin America, op. cit.*, p. 70. In the above-mentioned Final Report the participants also energetically supported the need to increase revenue and public expenditure (*ibid.*, p. 419).

³⁴ "Public expenditures and economic development", *Fiscal Policy for Economic Growth in Latin America, op. cit.*, pp. 135-147.

³⁵ The Final Report, after mentioning the need for augmented public expenditure, states: "It was recognized that much wasteful expenditure is undertaken in the Latin American countries. Greatly improved methods of overall investment planning, of project evaluation, of checking the performance of public sector operations, and of control over current expenditures of governments are all essential if the burdens of increased taxation are to bear the fruits to which the conference aspires". See *Fiscal Policy for Economic Growth in Latin America, op. cit.*, p. 419.

the term, it is not enough to affirm that revenue will be used for infrastructure, etc. A specific examination of the projects and expenditure to be undertaken is necessary in order to ascertain the social benefits and costs they involve and their integration in development plans;

(b) From the redistribution angle, it is not enough to know who is paying the taxes. It is also necessary to know who is benefiting from the expenditure;

(c) As regards stabilization policy, the necessity of relating income—basically tax revenue—with expenditure is only too obvious;

(d) From the political standpoint, the resistance already referred to is displayed against not only the amount but also the composition of public expenditure.

The Santiago recommendations could also be criticized for not taking due account of the differences existing between the countries, not only with regard to the socio-political order but also in questions directly related to the economy: disparate levels of development, production structure, degree of dependence on foreign trade and foreign investment, importance of resources already exploited and still to be developed, and size of the domestic market (obviously determined by population size, stage of development and income distribution). Clearly, a fiscal reform for, say, Haiti cannot be identical with one which would meet Argentina's needs; nor would the same change be required in Venezuela's tax system as in Brazil's.

These irrefutable reflections bring us just to touch upon a study by Harley Hinrichs³⁶ which deserves to be taken

³⁶ *A General Theory of Tax Structure Change during Economic Development*, Cam-

into account in view of the impact it has had on very wide circles. It could be described as a thesis based on a particular form of economic determinism. According to Hinrichs, taxes on foreign trade predominate in the early stages of economic development, since the export sectors are often those in the lead, and taxes of this kind are as a rule easier to control. Protectionist policies also tend to make use of customs tariffs or similar charges. As industries producing goods and services for the national economy develop, however, internal indirect taxes (on sales and specific consumption items) will grow. It is not until the last stages of economic development that direct taxes will predominate.³⁷ Consideration of several examples of empirical evidence fails to detract from the validity of this thesis, but neither does such evidence invalidate the opinions expressed regarding the pre-eminence of socio-political structures or power factors. Indeed, these changes in the economic structure could no doubt be linked with parallel changes in the power structure. Thus, Japan's economic development as from the restoration of the Meiji was characterized in the early period by a heavy tax on land, which served as an auxiliary instrument for the transformation of the whole system by contributing to the elimination of the feudal system and facilitating the transfer of capital to the manufacturing sector, whose development was initiated by the State itself. In the agricultural sector, production expanded, owing at least partly to the income-effect of increased

taxation. The land tax had to be paid in cash: a fact which necessarily brought the rural population into contact with the monetary economy. In addition, the heavy taxation demanded a greater effort on the part of farmers to maintain their standard of living.³⁸

Subsequently, with the appointment of Prince Matsukata as Prime Minister, taxes on consumption were substantially increased. In consequence of the development outlined the growth of agricultural and manufacturing production was vigorously promoted by the State, which not only established the infrastructure (railways, postal and telegraph systems and a much strengthened merchant fleet) but directly initiated practically all manufacturing production through State enterprises (most of which were subsequently transferred to the private sector). In the 25 years up to 1910, per capita income doubled while consumption figures were kept constant,³⁹ so that the level of living of most of the population remained below the acceptable standards in health, housing and other fields.⁴⁰ Thus, while the predominance of taxes on consumption

³⁸ It is worth recalling that the feudal lords—either directly or indirectly—invested the bonds they received in lieu of their previous right to levy taxation in industrial enterprises and were thus converted to the new industrialist creed.

³⁹ This was largely due to the heavy taxes on consumption and land (small landowners played a large part in the rural sector).

⁴⁰ Cf. Motokazu Kimura, "Fiscal policy and industrialization in Japan 1968-1995", in *The Annals of the Hitotsubashi Academy*, 1956; and William W. Lockwood, "The State and economic enterprise in modern Japan, 1868-1938", in *Economic Growth: Brazil, India, Japan* (ed. S. Kuznets, W. E. Moore and J.J. Spengler), Durham, Duke University Press, 1955.

bridge, Mass., Harvard Law School, International Tax Program, 1966.

³⁷ See also Richard A. Musgrave, *Fiscal System*, Yale University Press, 1969, particularly chapters 5-7.

which drastically affected the great majority of the population may obviously be explained in terms of a kind of evolution that is typical of tax systems, it is more important to relate it with the interests of the military-industrial complex than governing Japan.

The many studies made to determine the tax effort in various countries are linked with Hinrichs' approach inasmuch as their aim too is to identify economic factors influencing tax pressure. Thus it has been found that the level of per capita income, the opening-up of the economy, the importance of the mining sector and the degree of urbanization are factors —to mention only a few— that account for the 'tax effort'. The insistence on the need to consider other factors related to the power structure

implies no intention whatever of belittling the importance of such studies, for the following reasons:

(a) Emphasizing the factors related to the power structure does not mean that economic factors have exerted no influence;

(b) As already noted, the latter factors may be related to the power structure;

(c) Lastly, the gap between the effort actually made and that resulting from estimates (on the basis of a regression which incorporates the above-mentioned factors, i.e., per capita income, degree of openness of the economy, etc.) may testify to the intervention of other factors —of a political order, for example— which account for its existence.⁴¹

5.

A new attempt to promote tax reforms: the Mexico Conference

Gerson Da Silva, a Brazilian tax expert (who unhappily has since died), endeavoured with singular brilliance, dedication and effort to prepare a general scheme or model that could be used for all the Latin American countries, since it was stressed at the Mexico Conference in 1972 that a comprehensive analysis

would be undertaken which would make it possible to determine how far the model was susceptible of conversion into a proposition that could serve as a term of reference both for purposes of diagnosis and in order to offer guidelines for the reform of tax structures in Latin America.⁴²

⁴¹ Assuming that a country has a tax pressure of 15 per cent of the gross domestic product and that on the basis of the estimated regression for a group of countries this pressure (the tax effort) 'should' be 20 per cent of GDP, there is evidence here of the presence of other factors not considered in the regression.

Cf. R. J. Chelliah, "Trends in taxation in developing countries", IMF, *Staff Papers*, July

1971; R.W. Bahl, "A representative tax system approach to measuring tax effort in developing countries", IMF *Staff Papers*, March 1972; R. J. Chelliah, H. J. Baas and M. R. Kelly, "Tax ratios and tax effort in developing countries 1969-1971" IMF, *Staff Papers*, March 1975.

⁴² The italics are the present writer's. See OAS/IDB Joint Tax Program, "Consideraciones

The basic orientation of the studies presented by OAS had a notable virtue which should be highlighted: they expressly considered taxation as an instrument for promoting development. Thus, each type or group of taxes had a basic purpose.

In brief, the following were the main points of the model:

(a) It would be necessary to promote exports of Latin American manufactures. To this end, it was recommended that the rate of exchange be established at the level of the average productivity of the manufacturing sector, and that a progressive tax on exports of primary commodities be established, applicable to each product in respect of the difference between the sales price (equivalent to the current world price) and a basic price, the latter to be calculated, however, at the exchange rate in force prior to this modification;

(b) The protective function of customs duties should be separated from that of selectively restricting consumption, which should be assigned to an internal tax, leaving the function of protection to customs tariffs;

(c) A standard effective rate should be fixed for the customs duty on all products, with the exception of special customs treatment for incipient industries;

(d) The level and structure of consumption would be to some extent determined by income taxes and a general tax on sales of goods and ser-

vices, while the structure of consumption, in its turn, would be influenced by selective taxes on consumption;

(e) The purpose of the tax on land would be to push up its productivity;

(f) A number of tax measures were suggested as determinants of the optimum combination of the labour and capital factors, for example, the elimination of taxes on manpower and the use of the value added tax as a means of financing social security benefits;

(g) In order to maximize domestic saving on the part of enterprises, the model should have the following features;

(i) Dividends should be included in the taxable component of personal or family income subject to the global complementary tax, which would be strongly progressive;

(ii) Undistributed profits of enterprises should be exempt from taxation of any kind, irrespective of the type of enterprise (including partnerships and even one-man enterprises);

(h) The structure of investment would be determined by means of a special mechanism. This would consist in the establishment of an additional tax on the profits of enterprises, from which they could obtain exemption by depositing an equal sum to be used for investment in the enterprises for such purposes and on such terms as might be established by the authorities;⁴³

(i) With respect to tax policy as a determinant of income distribution, the conclusion was reached that this was unlikely to improve significantly, either through the use of progressive taxation or through the expansion of public expenditure. Of course, this does not mean that the governments of the Latin

preliminares de carácter conceptual y metodológico", *Reforma tributaria para América Latina. IV. La política tributaria como instrumento del desarrollo. Documentos y conclusiones de la III Conferencia Interamericana sobre Tributación* (Mexico, D.F., September 1972), OAS, Washington, D.C., 1973. Initial statement by the OAS Secretariat, p. 22, paragraph 45.

⁴³See the various studies prepared by the OAS Secretariat.

American countries should not make use of these fiscal instruments, but only that too many hopes should not be pinned on the success of such policies. Accordingly, the conclusion drawn in the study is that fiscal instruments should be used to generate substantial additional funds which can be earmarked for the creation of employment for the marginal population.⁴⁴

In line with the general approach described above, a praiseworthy attempt was made to focus attention on certain key variables — exports, investment, consumption, etc.— which can influence economic development, and therefore to analyse taxes as instruments for influencing those variables. Thus the approach based on an analysis by type of tax was superseded.

Another step forward was the explicit treatment of foreign trade. In the context of this group of taxes there was also a consensus on the separation of the protectionist function from that of restricting consumption.

It likewise seems desirable to provide export incentives, and modification of the exchange rate could be a means of doing so. Clearly, however, this does not solve all the difficulties arising if the aim is to establish an effective policy for the promotion of industrial exports. In countries with serious inflation it is not enough to establish a favourable exchange rate at a given moment; it is important to know what form the subsequent adjustment will take. Stress has often been laid on the desirability of gradual adjustments as a means of maintaining the initial favourable situation. Obviously, too, immediate devaluation,

which is of course bound to result from a more favourable rate of exchange for exports, could have a considerable impact on the internal economy, since it would necessarily force up domestic prices. These implications were not considered.

The elimination or reduction of taxes on manpower would seem advantageous, mainly in order to lessen the regressive elements in tax systems.

Lastly, an export tax such as that described would basically constitute a useful instrument for absorbing exceptional profits resulting from world price fluctuations.

There are, however, several questionable aspects:

(1) Public expenditure policy was almost entirely ignored, with one important exception which will be referred to later. To our objection it might be replied that in view of the specific aims of the Program, consideration of public expenditure would have exceeded its terms of reference. Although it is difficult to determine whether the restrictions were actually so rigid, in any case the point is that some group should have concerned itself with this subject and should ultimately have prepared a synthesis in order to assess — not only as a conceptual model but also for empirical research purposes or as proposals for action— the effects of fiscal policy as a whole.

From a different standpoint, emphasis could be placed on the need to consider all instruments of economic policy in order to judge the results obtained, but in this respect it must be taken into account that many of the effects of taxes and expenditure are by now hard to determine and the study would become even more complex if such an ambitious goal were aimed at.

⁴⁴ *Reforma tributaria para América Latina. IV. La política tributaria como instrumento del desarrollo, op. cit., p. 354.*

Of course, the ideal thing would be to have a complete picture of the effects of economic policy as a whole; but for the time being it would surely be a step forward to work out a reasonable result for fiscal action, and this aspect could then be incorporated in a more global and all-embracing scheme. Hence the assertion that an integrated fiscal study may be the first step towards a more comprehensive and quantified exposition of all the effects of economic policy. Indeed, what sense can there be in knowing, for example, that the tax system is progressive, i.e., that most of the taxes are paid by the rich, unless it is also determined whether perhaps it is the rich themselves who obtain the benefits deriving from the expenditure;

(2) The instruments are assumed to be ateleological, which implies reference to a system of taxes but not of tax rates, with complete disregard of the political aspects of the problem (the power structure) as well as of other questions which relate to the level of taxation, since one and the same system cannot be applied for a tax pressure of 8 per cent and for another of 30 per cent;⁴⁵

(3) The optimism which attributes remarkable efficacy to the tax instrument is sometimes unwarranted. Thus, although there may be agreement on the need to reduce the social security contri-

butions (taxes on manpower designed to make the system more progressive), the effect on the combination of factors is not thought to be necessarily important in every case.⁴⁶ That is to say, other technological options do not always exist, besides which the available techniques were generally devised in countries where capital is the scarce factor.

This same confidence is displayed with respect to the effect of the system of incentives that is advocated. The mechanism recommended by OAS is probably more effective than those commonly used, such as accelerated depreciation, but the fiscal cost will also be greater, a fact of which no mention is made at all;

(4) In contrast, the opinion on income distribution alluded to above—to the effect that it is, of course, reasonable not to expect too much from any possible redistributive action in Latin America's present situation—seems unduly negative. Moreover, no clear indication is given of the difference between what actually exists or has existed and what could be achieved under a government which really wishes to improve the distribution of income. Lastly, the final observation regarding the advantage of creating employment for the marginal

⁴⁵ See, for example Richard A. Musgrave, *Propuestas de una reforma fiscal para Colombia* (ed. Malcolm Gillis, Spanish version by Miguel Urrutia), Bogotá, Banco de la República, 1974, p. 45, where it is explained that the content of the reform will vary considerably according to the goal pursued (in respect of income). It would be a mistake, however, to assume that the target for fiscal revenue can be established independently of the feasibility and content of the tax reform. The interdependence is reciprocal . . .

⁴⁶ Cf. David Felix's interesting comments on what he calls the 'relative price approach'. This point of view, he says, has some valid features, in particular its recognition that an effective technological policy should not concentrate merely on an increasing flow of information but should be linked with economic policies that will eliminate the elements of bias in decision-making which distort the selection of technology. The basic weakness of the relative price approach is that it greatly oversimplifies the technological option matrix. See *Development in Latin America: A general analysis and recommendations for technological policy*, CEPAL, Santiago, p. 18.

population –desirable though this is— puts redistribution through fiscal policy in the lowest possible terms;

(5) The complete exemption of undistributed profits –which is one of the suggested ways of promoting saving— could lead to a situation where the tax on income from capital would cease to exist entirely, considering that generally speaking it is easy to convert the payment of dividends into the distribution

of shares which would then be sold without payment of any taxes, since the model includes no capital gains tax either.

To sum up, therefore, although the general approach is an interesting one and a number of very important aspects have been highlighted, the model is not sufficiently complete, nor is it applicable to all the countries, and it fails to consider all the objectives that fiscal policy can fulfil.

6.

The experience of some developed countries in tax policy for growth

Thus far, some tentative comments have been made on general reforms for Latin America and the tax structure has been evaluated from an angle favouring a progressive system, for which purpose, as a first approximation, global relationships such as the ratio of direct taxes to total tax revenue have been used.

Since it is not only the redistribution of income that is of interest, but also the use of fiscal instruments for development, it is worth while to review the experience gained in some developed countries in the post-war period up to 1963. To this end, the most important statements made at a special conference held at the end of 1963 in the Brookings Institution (Washington) have been summarized.⁴⁷ Despite the passage of time, this report is still considered a basic study,⁴⁸ and the decision to

comment on it has not been idly taken.

Although a more thorough analysis will be made later, it is useful to state beforehand the following conclusions that emerged from the papers presented and from the discussion among the participants:⁴⁹

(a) One of the points emphasized was the difficulty of relating differences in the growth rates of the various countries to specific tax measures;

(b) Few would deny, however, that tax policy has had some influence on growth. But even in those countries where the influence of action in the tax area was greatest –Japan, Germany and

Retrospect and Prospect”, *Public Expenditures and Taxation*, New York, 1972, p. 25; and some general considerations by Stanley S. Surrey and Emil M. Sunley, Jr. on fiscal incentives as instruments for the attainment of government objectives, *Cahiers de Droit Fiscal International*, vol. LXI, Title 1, p. 30.

⁴⁹ The following countries were included in the study: Japan, the Federal Republic of Germany, Italy, the Netherlands, France, Sweden and the United Kingdom.

⁴⁷ See National Bureau of Economic Research, *Foreign Tax Policies and Economic Growth*, New York, 1966.

⁴⁸ See, in this connexion, National Bureau of Economic Research, “Economic Research

Italy— there were other factors which contributed to a vigorous demand for investment goods with a view to exploiting the expanding markets, while an abundant reserve of unemployed or immigrant workers was also available. Export markets played a key role in the Netherlands, France and Germany; and Japan was particularly favoured by a low capital-output ratio;

(c) Special attention was paid to growth resulting from greater capital formation. It was stressed in this respect that in the promotion of saving a major factor was public saving, whether for financing the government's own investment—as in the Netherlands and Sweden— or for granting loans to the private sector;

(d) It was concluded that the measures to encourage personal saving were costly and not very effective;

(e) According to a majority of the participants, investment incentives had played an important part in determining both the use and the level of investment. In particular, they thought that results justified the 'carrot and stick' policy;

(f) It was felt that too little is known about the effects of tax measures on savings and investment decisions and, consequently, more quantitative studies were needed.⁵⁰

The following views of individual participants are worth noting:

The representative of Japan underlined the fact that despite the low level of government revenue, the public sector's net saving and investment were substantial, because of the low levels of social security and defence expenditure. He further stressed the importance of

moderating the progressiveness of the tax system; a better solution, he concluded, might have been to increase government saving by raising taxes rather than to promote saving by means of tax incentives.⁵¹

An expert commenting on the German tax system noted that as from 1951—i.e., when the general state of the economy had been normalized— special investment incentives were granted only in favour of basic industries, housing construction and ship-building, and export industries. The favourable treatment accorded to the retention of profits was modified as from 1953, when it was established that distributed corporate profits were to be subject to a lower rate than retained profits.⁵² It should be noted that another German participant severely criticized the adverse effects of the measures adopted on the distribution of income and net wealth.⁵³

The provisions in force in Sweden up to 1951 as regards depreciation of fixed assets were based on a system granting free depreciation of their machinery and equipment to corporations and other associations taxed at proportional rates. Some restrictions were introduced from 1951 onwards, and in 1955 a new system was established which laid down less advantageous procedures for net reinvestment (cost of new capital goods less sales value of those replaced) with an initial depreciation of 30 per cent.⁵⁴

⁵¹ See Ryutaro Komiya, "Japan", *ibid.*, pp. 39-90.

⁵² See Karl Häuser, "West Germany", *ibid.*, pp. 97-152.

⁵³ Comment by Fritz Neumark, *ibid.*, pp. 152-164.

⁵⁴ See Leif Mutén and Karl Faxén, "Sweden", *ibid.*, pp. 337-389. No comments are made here on the investment reserve system since its purpose is basically countercyclical rather than growth-promoting.

⁵⁰ See E. Gordon Keith, "Introduction and summary", *Foreign Tax Policies and Economic Growth*, *op. cit.*, pp. 35-37.

The absence of taxes on capital gains and the complete freedom to determine the salary which a corporation paid its executive director, if he were also a shareholder, influenced the large-scale establishment of such corporations, which were considered to be elements promoting growth.⁵⁵ Furthermore, the provisions concerning depreciation—though less liberal than before—and the considerable freedom in respect of the valuation of inventories were also factors that encouraged growth (because of the greater stimulus given to expanding enterprises). The last feature of the Swedish tax system mentioned was the introduction of a sales tax that was not considered to favour growth since it was imposed not only on consumer goods but also on investment goods.

In the case of Italy, stress was laid on the burden of indirect taxes (which exceeded direct taxes, with social security contributions included in the latter group); social security contributions, for their part, increased by 1 000 per cent in constant terms in the 15 years following 1947. The heaviness of indirect taxation, combined with considerable tax evasion in the middle and upper income categories which the tax authorities were incompetent to prevent, meant that the overall distribution of the tax burden was predominantly proportional or regressive.⁵⁶

For the present study, concerned as it is with the developing countries, special interest attaches to the series of tax incentives granted for the development of southern Italy.⁵⁷ Enterprises investing in the South were exempted

for a period of 10 years from the movable wealth tax (a form of schedular tax on income) on the resulting profits. The enterprises were subject to other forms of income tax (for example, corporate tax). Under the laws in force, the exemptions covered only industrial enterprises with fixed investment such as plant, machinery and other equipment technically organized for production. Also exempted from the movable wealth tax were all enterprises located anywhere in Italy which invested their profits in the South. The exemption could not, however, exceed 50 per cent of the profits or of the investments placed.

Lastly, there were exemptions in the field of indirect taxation. In the early years of the enforcement of this law no large-scale investment appears to have been made as a result of the promotion laws, but this situation gradually changed at the beginning of the 1960s, which means that the effects of the incentives need time to mature. This is explained by a number of external economies which existed in the North, and which developed only little by little in the South (for example, manpower trained for industrialization).

By and large it is important to bear in mind that in general terms the system contained several elements which made it inefficient in promoting economic development: the high cost of collecting taxes, ways of imposing indirect taxes which distorted the structure of production,⁵⁸ a direct tax system which penal-

⁵⁷ The Cassa per il Mezzogiorno originally allocated its funds to public works. See "Italy", *ibid.*, p. 196.

⁵⁸ Comment by Siro Lombardino, *ibid.*, pp. 203-206. With respect to the effects on productivity, Lombardino presumably had in mind, in particular, the existence of a corporate

⁵⁵ "Sweden", *ibid.*

⁵⁶ Francesco Forte, "Italy", *ibid.*, pp. 173-190.

ized productivity, and in addition, procedures for determining direct taxes which created a sense of insecurity among entrepreneurs.

The tax structure of the Netherlands in the period under review was practically the diametrical opposite of Italy's. In the Netherlands the participation of direct taxes was high; in 1959 the tax on personal income alone represented about 40 per cent of total tax revenue. In addition, the system was preponderantly centralized. Among the tax measures adopted, as in several developed countries, accelerated depreciation was permitted from the time of placing an order for the purchase of a capital good, in addition to an initial deduction of one-third of its cost. However, the total amount of amortization during the useful life of the good was not changed by this provision. The Tax Revision Act of 1950 also permitted a once-only revaluation of certain capital goods in amounts varying according to the purchase date. The cumulative burden on capital gains resulting from the company tax, income tax on dividends, and the property tax was for the highest incomes close to 100 per cent. There were a number of special provisions to encourage saving (relating, for example, to non-taxable reserves and promotion of small savings). It is important to note that there were some tax reductions, and estimates were presented according to which the reductions in the capital gains tax constituted the most significant factor in increasing investment.⁵⁹ Attention was also drawn

tax on capital returns exceeding 6 per cent. As regards indirect taxation, at that time a cumulative tax existed, with the effects that are normally ascribed to taxes of this type (differences according to degree of vertical integration).

to the tax rebates on profits used for investment, which promoted company saving. These consisted in the possibility of deducting from taxable profits, during a period of five years, up to 4 per cent of the total cost of new capital goods, without any reduction of the basis (cost) of these assets for depreciation purposes. Lastly, mention was made of some measures to encourage small savings (tax freedom for premiums on savings in the case of small savers).

The French tax system was also characterized by a very high proportion of indirect taxes (70-77 per cent of total tax revenue). In a study undertaken by the Ministry of Finance, however, the conclusion was reached that indirect taxes were progressive in respect of income owing to the heavy taxes on luxury or semi-luxury goods. In France too, several provisions had been adopted to promote saving (exemptions from income tax on interest on government securities or deposits in the National Savings Fund, and exemptions from inheritance tax on certain government bonds). A number of measures were applied to encourage investment: initial deduction, exemption for capital gains realized from the sale of fixed assets when the proceeds were reinvested in the enterprise, revaluation of assets (up to 1959 revaluation profits were exempt from profits taxes, but a tax of 3 per cent was imposed on the reserve), and the carrying-forward of losses for income tax purposes. Stress was laid on the stimulus given to investment by the deduction of most investment goods which was authorized for purposes of payment of the value added tax (consumer system).⁶⁰

⁵⁹ See Cornelius Goedhart, "The Netherlands", *ibid.*, pp. 207-266.

Stress was also laid on the system's advantages, such as the conversion of the schedular tax on income into a global tax. Similarly, the significant growth of

consumption was highlighted as a factor stimulating overall demand. This growth took place in spite of the heavy taxes on consumption.

7.

Special consideration of fiscal action bearing on redistribution

Since throughout this study special emphasis has been placed on the redistributive function of fiscal policy, a more careful examination must be made of the real possibilities of its fulfilment. For this purpose it is useful to determine the results thus far achieved in the areas of both taxes and expenditure. Fortunately, Richard Bird and Luc Henry de Wulf have reviewed and summarized the studies carried out in Latin American and other countries.⁶¹

The purpose of the study on fiscal incidence, i.e., on the distribution of the tax burden and the benefits of public expenditure, is to determine *ceteris paribus* the effects on income distribution produced by government action through budgetary instruments. To

enlarge upon this general concept, the State may be said to modify the distribution of income through the following operations:

(a) By taxing a proportion of income, it brings down the relative position of some groups;

(b) Through transfer payments it influences the situation of the beneficiaries;

(c) It provides services which also benefit specific groups; and

(d) Lastly, it supplies public goods which, in principle, benefit the community as a whole.

The analysis of the incidence of taxes is the very essence of the study of their economic and social effects. Its purpose, expressed in the simplest terms, is to determine who in the last instance bears the tax burden. The incidence hypotheses are a basis for estimating the distribution of the tax burden borne by each of the socio-economic classes broken down by personal-income brackets. For this assignment of taxation certain indicators are required which quantitatively relate the incidence assumptions to the group of persons ultimately bearing the burden of each tax. If, for example, the conclusion is reached that smokers pay the tax on cigarettes, information will be needed on

⁶⁰ See Pierre Tabatoni, "France", *ibid.*, pp. 275-335.

⁶¹ See Richard M. Bird and Luc Henry de Wulf, "Taxation and income distribution in Latin America: A critical review of empirical studies", *IMF Staff Papers*, vol. XX, N° 3, November 1973; and Luc Henry de Wulf, "Fiscal incidence studies in developing countries: Survey and critique", *Staff Papers*, vol. XXII, N° 1. According to the first of these, 20 studies on the distribution of the tax burden in Latin America were found to exist. Excluding the three studies carried out or directed by the writer of the present article, hardly any of the rest were prepared by Latin Americans.

the distribution of the consumption of cigarettes in each population group. In other words, what is important here is the impact of a tax on the real disposable income of persons or households; and this impact depends on the changes in the relative prices of products and factors. Thus, when a product is taxed, it is assumed that the price will increase, thereby affecting the consumer, in a first approximation. Once the incidence of a tax is determined, other effects may supervene. Consumers of the taxed product may change their consumption patterns, and the producer enterprises, for their part, may modify the allocation of resources (capital and labour), possibly reducing the quantities used in the production of the taxable good.⁶²

Incidence theory represents one of the most difficult areas of public finance. A considerable number of theoretical studies exists, as well as an increasing amount of empirical research, the latter, however, referring only to developed countries.⁶³ These are the two components forming the basis for premises on which to build hypotheses applicable to each individual tax.

Moreover, there are many studies on the distribution of the tax burden relating both to developed and to developing countries.⁶⁴ An additional basis is thus available, since a procedure has

⁶² See Joseph A. Pechman, Benjamin A. Okner, *Who Bears the Tax Burden*, Washington, D.C., The Brookings Institution, 1974.

⁶³ Cf. P. M. Mieszkowski, "Tax incidence theory: The effects of taxes on the distribution of income", *Journal of Economic Literature*, vol. 7, December 1969. It must be borne in mind that even empirical studies do not necessarily arrive at the same findings. For example, there are some dealing with the tax on income of corporations which have reached opposite results as regards transfer possibilities.

been worked out which is considered generally acceptable, at any rate for most taxes.

To give an idea of the difficulties encountered, reference may be made to the tax on the income of corporations. The incidence assumption depends on the structure of the market. The transfer of the tax does not occur under perfectly competitive and monopolistic conditions; under an oligopolical system, on the other hand, the final incidence depends on the hypotheses concerning the reactions of oligopolists to changes in prices and quantities.

In the developed countries, corporations are not taxed in the same way as other taxpayers. In this connexion, several studies have attempted to verify that the corporate tax is transferred, and is therefore not paid by the entrepreneurs or shareholders but by the consumers.⁶⁵

Of the studies on Latin American countries reviewed in the above-mentioned article —excluding those on Jamaica and Puerto Rico— only two (Panama and Peru) indicated the existence of a progressive tax system; the others showed that the system was basically proportional, or even regressive for most income brackets.

In the area of expenditure, according to a classification presented in the study by Luc de Wulf, three ways of analysing the impact of government expenditure can be distinguished:

(i) The approach based on monetary flows, or, in other words, on deter-

⁶⁴ See "Taxation and income distribution in Latin America: A critical review of empirical studies", *op. cit.*, and "Fiscal incidence studies in developing countries: Survey and critique", *op. cit.*

⁶⁵ Cf. *Who Bears the Tax Burden*, *op. cit.*, pp. 34 *et seq.*

mining who receives the payments made by the government;

(ii) The benefit criterion, which centres on the results obtained through public expenditure; and

(iii) The effects which public expenditure is likely to have on the production structure of an economic system, as well as on the prices of products and of the factors of production.⁶⁶

The purchase of medicaments for a hospital, according to the first approach, represents a payment to the producer of those goods. According to the second criterion, it represents a benefit for the group of persons receiving attention at the hospital. The third method is obviously the most complete, and would raise the question—for example—of what types of enterprise benefit from the purchase made, and what are the repercussions on other industries such as those supplying inputs to producers of medicaments.

In the empirical research published in several countries, attention was almost exclusively centred on examination of the benefits deriving from public expenditure action (procedure (ii)). The benefit concerned will be determined by the results of the service that the State provides. More explicitly, by this method the various items of public expenditure are assigned to homogeneous population groups or classes, albeit the ideal system would be to assign them by personal income categories.

Public expenditure may be subdivided into general public expenditure, also called pure public goods, and specific expenditure.

⁶⁶ Cf. "Fiscal incidence studies in developing countries: Survey and critique", *op. cit.*, pp. 75-92.

The concept of a pure public good originated from the need to clarify the characteristics peculiar to State functions on the basis of examination of an extreme case. The point is, in essence, to distinguish public goods from those obtained on the market (private goods). The exclusion principle is applicable to the latter, in the sense that the consumer is excluded from use or enjoyment of a good unless he pays a price to obtain it. This principle does not apply in the case of pure public goods, since consumption of a service benefiting one person does not mean the exclusion of another. Recently, with the continuance of discussions and controversies about the characteristics of public goods, stress has been laid on the fact that it is not only the non-application of the exclusion principle which distinguishes these goods but also the peculiarity that they are items of joint consumption. Expenditure on national defence would be a case combining both these features; on the other hand, movement in the streets of large cities during the rush hours exemplifies a situation where the exclusion principle could not possibly be applied. Lastly, the use of a bridge where there was no traffic congestion would allow the exclusion principle to be applied through a toll, but it would nevertheless be a public good since it is an item of joint consumption.⁶⁷

One of the major difficulties from the conceptual standpoint in studies on the incidence of public expenditure concerns precisely the outlays covering these pure public goods. To give an empirical content to these observations, it may be

⁶⁷ Cf. Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and in Practice*, New York, McGraw Hill, 1973, pp. 52-56.

noted that in the majority of the studies on the incidence of expenditure,⁶⁸ the distribution of the expenditure was based on income or on the number of households or persons composing each income category. Emphasis must be placed on the significance of this assignment for a complete evaluation of the effect of public expenditure, and also for assessing the total incidence of a government's fiscal action. In fact, the items referred to —i.e., public expenditure proper— may represent up to 50 per cent of total expenditure, which shows the supreme importance of the criterion to be applied.⁶⁹

Although from the conceptual standpoint expenditure not included in the category of public goods proper can be assigned easily —one might almost say, by definition—, in practice there is not always sufficient information to determine exactly who is benefiting from a specific expenditure. In theory, a highway is used by a well-defined group, but for an empirical study an indirect indicator should be used in assigning the relevant expenditure. Cases in point

might be the consumption of gasoline by income groups, or the possession of motor-cars. It must be borne in mind, however, that generally speaking highways are also used for the transport of goods. Consequently, a necessary first step is to estimate the proportion of passenger and of goods traffic, and only then will it be possible to assign the expenditure on passenger transport by income groups. Even in simpler cases problems arise: will expenditure on education be distributed on the basis of the income of the parents or of the students? The first procedure is normally recommended, since the household is the most meaningful group for the purposes of analysing income distribution.

According to Wulf's study, the findings of the research on the distribution of benefits resulting from public expenditure —with all the limitations deriving from the premises which formed the basis for the distribution of expenditure, particularly the outlays bringing general benefits— show that the lower income groups have benefited more than the higher income strata.⁷⁰

It may therefore be maintained that in several countries public expenditure has had some effect on income distribu-

⁶⁸ See "Fiscal incidence studies in developing countries: Survey and critique", *op. cit.*

⁶⁹ Cf. George E. Lent, "La política tributaria en cuanto determinante de la combinación óptima de los factores capital y trabajo", *La política tributaria como instrumento del desarrollo*, *op. cit.* In 1964, on the basis of a study by the World Bank with data for 46 countries, the author prepared the following estimates:

- (a) General administration, approximately 15 per cent;
- (b) Defence, 15-20 per cent;
- (c) Economic services, 25-30 per cent;
- (d) Social services, 25-30 per cent; and
- (e) Non-assignable, 5-20 per cent.

Here, in principle, items (a) and (b) would belong to the public goods category, and group (c) should be similarly assigned for want of an alternative criterion.

⁷⁰ Nothing has been said here of the studies on total budget incidence. The problem arising in these studies is that income —i.e., total tax revenue— is not equal to total expenditure, part of which may be financed in other ways (for example, by deficit financing). Although ideally these would have to be included and their effect on the distribution of income examined, in practice the budget study includes only taxation and expenditure, the latter exceeding the former. The findings of this kind of study should therefore be interpreted carefully, since the excess of expenditure over tax revenue by no means implies that the benefits exceed their cost. Of course, in research of this kind the comparative analysis for households belonging to different income strata is still valid.

tion, although the difficulty of assigning expenditure on general benefits must always be kept in mind.

Only past events have been reviewed so far, with no mention of the future. If it is considered that certain expenditure, such as that on education and health, has not been adequately extended to all the low-income groups, for example, the rural population, there is nothing to prevent its reaching them too, given the

necessary effort and, possibly higher costs. The same reflection applies to taxes; if today the system is regressive, it is not bound to remain so. The studies on the distribution of the tax burden show that even regressive systems contain some progressive taxes, such as personal income tax and certain taxes on property. Of course, these observations on expenditure and taxes are only in the nature of a first general picture.

8.

Fiscal policy and investment

Another objective meriting special attention is investment. Ideally, it should be interpreted in a broad sense, that is to say, including investment in human resources or in development institutions,⁷¹ but in practice it is given its traditional sense (in accordance with the national accounts classification). Perusal of the bases of the incentive laws existing in the Latin American countries would suggest that it is the easiest thing in the world to boost investment merely by granting tax incentives. Clearly, this over-simplifies an intrinsically complex problem which even the substantial resources allocated to its study in the developed countries have not sufficed to resolve. A number of questions must therefore be analysed even before embarking on examination of the effects of such incentives.

The first step is to determine the importance of public investment, a crite-

riterion naturally dependent on the political approach ('interventionism' or 'liberalism'), but also influenced by the stage of development reached, which may require a greater or lesser volume of the investment in infrastructure that is generally the responsibility of the government. This is also applicable to the formation of public or private saving. It should be recalled that in several developed countries particular importance was attached to public saving, which in some cases even provided funds for private investment.

Where economic development is the sole objective, it might be considered desirable to promote both public and private saving and investment. In principle, there is nothing wrong with maintaining such a position, but it would be dangerous to do so without bearing in mind that at any moment conflict may arise between public and private capital formation. If public investment were very substantial and taxes on the private sector were increased correlatively, a point might be reached where funds —or

⁷¹ Cf. Federico J. Herschel, "Determinantes del desarrollo", *Desarrollo económico*, vol. 1, N° 4, January-March 1962, p. 125.

foreign exchange— were channelled away from private investment. Similarly, if incentives were progressively stepped up, there might be a shortage of resources to finance public investment.

Although the studies on incentives carried out in both developing and developed countries deal mainly with the effects of income tax incentives, an immensely powerful stimulus is provided through import tax policy. This policy is implemented not only by means of protectionist duties designed to create a market from which foreign competition is excluded, but also by exemptions or reductions for inputs, and, particularly, for capital goods. A demand is thus created which requires investment in order to be translated into actual production. Moreover, the franchises for inputs bring down the cost of production, which constitutes an additional incentive, and the exemption of capital goods from import duties also means a reduction in costs which can be considerable if the rates applied—where no such exemption is granted—are high enough.

Of course, the strongest influence is exercised on the structure of investment, but it seems reasonable to affirm that in periods when import substitution is dynamic—i.e., while the possibilities of the model are still not-exhausted—there will also be an increase—probably considerable in some cases—⁷² in total investment.

Obviously, the effects of the system of import taxes in force have not necessarily determined the best possible composition of investment or, therefore, the optimum production structure, since the

⁷² For a supporting opinion on the significance of import duties, see George E. Lent, "Tax incentives for investment in developing countries", *Staff Papers*, vol. XIV, N° 2.

production of consumer goods was for a long time exclusively favoured in Latin America.⁷³

It must be emphasized that if in general fiscal policy should further the aims of medium- and long-term integrated development, in the specific case of taxes on external trade this suggestion becomes an imperative. Only with an image of the future production structure in mind is it possible to map out a policy, i.e., the structure and rates of taxes affecting foreign trade.⁷⁴

The point that will next be discussed is the influence which taxes incident on the domestic economy, and particularly income tax, can exercise on the level and structure of investment.

In order to ascertain the effect of measures to liberate investment from income tax, a preliminary conceptual analysis should answer the following questions:⁷⁵

⁷³ See, in this connexion, *La revisión de la política arancelaria centroamericana*, SIECA/75/FIA/24/1, vol. I, 30 June 1975, p. 19, for a comment to the effect that dependence [on the performance of the world economy] is intensified by the additional circumstance of very low real rates of taxation on inputs and capital goods and high tariff levels for finished goods. In fact, the enlarged and protected market and the high proportion of exemptions encouraged installations which resulted in idle capacity, transferred external dependence to the aforesaid inputs and capital goods, and confined production, in the main, to final processing levels.

⁷⁴ Implicit in the reference to external trade is the fact that export taxes likewise can be scaled according to the stimulus it is desired to provide for various sectors.

⁷⁵ No mention is made here of another prior question, i.e., what is the role of physical investment in the economic development process? Although, generally speaking, few would deny the importance of capital formation, in some circumstances there could be another key

(1) What investment theory is accepted, or what is the one considered applicable in each case?

(2) What is the incidence assumption accepted—a particularly important point in the case of corporations?

(3) What other factors have played a part in determining investment?

(4) What is the cost of the incentives?

With respect to point (1), economists in the developed countries are not in agreement as to the investment theory affording the best explanation and the most convincing proofs. Some uphold the maximization of entrepreneurial profits, an assumption which also necessitates the existence of a production function. In principle, according to this approach, a tax incentive would influence the rate of return of an enterprise, even if the proposed investment also depends on the substitution-elasticity of the factors of production. Other economists support the accelerator theory, whereby investment is adjusted to the

factor, for example, the formation of "human capital" or the introduction or invention of technological innovations (cf. Mario Brodersohn, "Incentivos fiscales y estímulos a la inversión privada", *La política tributaria como instrumento del desarrollo*, *op. cit.*, p. 470). Several studies have shown that the social productivity of investment in human capital is higher than that of investment in physical capital. A number of others have stressed the fundamental importance of technological change, primarily in developed countries, though some have also been prepared with reference to developing countries (see, for example, Jorge M. Katz, *Production Functions, Foreign Capital and Growth in the Argentine Manufacturing Sector*, Di Tella Institute, Centre for Economic Research, Buenos Aires, 1968; and F.J. Herschel and J. Nogués, "El cambio tecnológico y la aplicación de un método para el análisis en una industria", *Revista de Economía Latinoamericana*, No 34, 1972).

rate at which production changes. This specification was later modified to include both the product (or its rate of change) and the stock of capital.⁷⁶ Lastly, consideration was also given to available flows of funds (retained earnings and depreciation reserves) as determining factors of investment.

A tax incentive involving a reduction of income tax influences, in principle, the entrepreneur's profits and the funds he has at his disposal for investment. Accordingly, it would seem *prima facie* that the incentive may have an effect on investment if the first and last of the schemes described are accepted or verified. This would not happen if application of the acceleration principle is assumed, since income tax does not directly affect the value of the product or its rate of change.

As regards the incidence hypothesis, it was long thought that income tax, applicable as it is to net returns, was not

⁷⁶Cf. Lawrence R. Klein and Paul Taubman, "Estimating effects within a complete econometric model", *Tax Incentives and Capital Spending* (ed. Gary Fromm), Washington, D.C., The Brookings Institution, 1971, pp. 197-207; the theory of product level, not product change, is set forth by W. Baumol in *Business Behaviour, Value and Growth*. Mention should also be made of the flexible accelerator theory, according to which the adjustment of investment to the stock of capital required for a specific level of production is not instantaneous but gradual, the issue being also affected by the stock of capital at the beginning of the period. (Cf. Michael K. Evans, *Macroeconomic Activity—Theory, Forecasting and Control—An Econometric Approach*, New York, Harper and Row, 1969, pp. 84 *et seq.*) In somewhat more complex investment functions, the degree of utilization of capacity is included among the independent variables. See also Federico J. Herschel, *Introducción a la predicción económica*, CEPAL, November 1974, pp. 109-114.

transferable, for as it was less than 100 per cent it did not alter the point of maximum return. In practice, several empirical tests have been carried out, and the impression now exists that the tax can be transferred. In the event of adoption of the hypothesis postulating total transfer of the tax in combination with the theory of maximization of profits or the theory assigning importance to the available supply of funds, the incentives would cease to have any effect because the consumer would benefit and not the entrepreneur. (Nor is it impossible for an asymmetrical type of behaviour to exist whereby the entrepreneur transfers the price increase due to a higher tax, but would not reduce the price if the tax were lowered—a case of downward inelasticity.) The answer to the third question is fairly obvious. Other factors may be more important, a recession, for example, or social or political insecurity; the incentives would be inoperative even if the hypothetical profit were to increase.⁷⁷

Restrictions of fundamental importance are the balance-of-payments position and the availability of credit, both of which can act as a brake on investment, even though incentives may offer a higher potential return.

As a first approximation, the cost of the incentives is constituted by the loss to the Treasury, i.e., the tax revenue that is forgone, but the question then arising is what the government will do when its income declines. It may increase other taxes, in which case their implications

too would have to be considered. It may feasibly reduce its spending; if, for example, it were to cut expenditure on public works, increases in private investment would be effected at the expense of public investment. Lastly, account must be taken of the deterioration in the progressiveness of the system, always provided that the assumption of non-transfer were valid.

Conceptually, these reservations would also be applicable to the effect deriving from import duties; however, the impact of these taxes and the evidence found in all the Latin American countries show that, whatever investment theory is applicable, they have influenced the establishment of many industries and, therefore, the creation of the necessary investment. Again conceptually, the reservations concerning the fiscal cost—which in this case would be represented on the one hand by exemptions and reductions for inputs and capital goods, and on the other by such high levels of protection as to prevent the taxed products from being imported—are likewise fully applicable.

Now that the indispensable basic concepts have been clarified, it is of interest to comment, albeit briefly, on the empirical analyses of the relationship between investment and incentives. A first point to consider would be the lessons to be learnt from some comparative studies, taking into account, for instance, the experience of the developed countries (see section 6). The most important of these lessons would be the following:

(1) If in certain developed countries the social cost of some of the measures adopted has been stressed, it is obvious that the cost must be greater in the Latin American countries, where the distribution of income and wealth is more

⁷⁷See Mario S. Brodersohn and Federico J. Herschel, *Estímulo a la inversión industrial mediante incentivos tributarios en la Argentina*, a paper presented at the Conference on Public Finance held at Córdoba, Argentina, in July 1968.

unequal and, moreover, critical poverty exists, characterized by the impossibility of satisfying a human being's minimum needs;

(2) The role of the public sector in the establishment and expansion of infrastructure tends at least to be the same in the countries of Latin America as in the developed countries;

(3) It may be assumed that, generally speaking, entrepreneurs in the Latin American countries are less likely to make exact or highly probable calculations of potential returns than entrepreneurs in developed countries. The intention here is to refer not to the problem of a possible shortage of genuine entrepreneurs prepared to take on risks and co-ordinate the factors of production, but to the more obvious fact that social and political instability and frequent changes in the orientation of governments' economic policy make it difficult to undertake a strictly accurate cost-benefit analysis;

(4) The interdependence of high rates and the effect of incentives must be underlined. In this respect, it should be pointed out that the rates of taxation established by law in the Latin American countries tend to be lower than those in force in the developed countries in the period under review. Noteworthy, too, is the fact that the real rates in the countries of the region may be estimated to be even lower, because of the scale of tax evasion.

Fortunately, a number of empirical studies are available on the Latin American countries; according to these, the effect of fiscal incentives on investment has been somewhat limited.⁷⁸

⁷⁸ Cf. Mario Brodersohn, *La política tributaria como instrumento del desarrollo*, *op. cit.*, p. 469, where it is maintained that the small

As was to be expected at the present stage in the development of economic science, attempts have also been made to incorporate the tax variables in functions or models. Outstanding among the studies carried out in developed countries is one compiled by the Brookings Institution for the purpose of measuring the influence exercised on investment by the incentives in force in the United States (accelerated depreciation, tax credit).⁷⁹ In spite of the quality of the research, varying results were obtained.⁸⁰

In some attempts to measure the effects of taxation on investment in Latin American countries, no evidence

part played by fiscal incentives in the investment decisions of enterprises is due to a group of factors which, although dependent on the particular characteristics of each country, acquire importance in most of the Latin American countries. Notable among these factors are: the low tax pressure resulting from low effective rates, from the laxity of tax regulations or from inefficiency on the part of the authorities in controlling the enforcement of the regulations in question; the slow and complex administrative procedures that enterprises have to go through in applying for tax benefits; uncertainty as to the duration of the incentives for investment projects with long lead times, owing to constant unforeseen changes in government authorities; the vague and imprecise definition of the economic activities qualifying to benefit from the incentive, as reflected in the discontinuous and discretionary processes whereby the enterprises or areas of activity eligible for tax exemptions are selected. It is further contended that the efficacy of the incentives has been slight because they are scattered over a great many activities or regions, making a minimal contribution in each, owing to the fact that the governments' budget requirements prevent them from granting substantial or extensive tax exemptions. See also Federico J. Herschel, *Ensayos...*, *op. cit.*, pp. 498-501, 542-548.

⁷⁹ Gary Fromm (ed.), *Tax Incentives and Capital Spending*, *op. cit.*

⁸⁰ *Ibid.*, Introduction by G. Fromm, p. 1.

was found of their having influenced capital formation.⁸¹

There is one effect of fiscal incentives which has not been discussed, i.e., the effect on the structure of investment produced either by levying higher taxes

on one sector of the economy than on another,⁸² or by taxing a specific kind of investment.⁸³ The conclusion generally reached is that this impact is usually considerably greater than the influence exerted on total investment.

9.

Final reflections: proposals for a fiscal reform and its political viability

Wide-ranging as have been the questions discussed, not all the important points have been dealt with. A case in point is the multiple-budget system, under which stabilizing action should not affect either development policy (Musgrave uses the term 'allocation')⁸⁴ or income distribution policy. Nor has anything been said of the (automatic) flexibility and power of reaction of the tax system, which are factors that can be important in securing adequate financing for integrated development. These points are mentioned

here with the purpose of drawing attention to the complexity of the subject and the different nuances which should be considered in a more specific analysis.

Since the value judgements of the author have already been indicated, it seems needless to dwell on them further. All that may be worth while is to add that the importance assigned to redistribution or to social development is also based on available data and reports which testify to the crisis of what has been called 'elusive development'.⁸⁵

Moreover, it is important to clarify that the greater significance assigned to redistribution is not absolute: in fact, the countries need both economic and social development as long-term objectives, but in a first stage preference should be given to the redistribution of income in order at least to eliminate critical poverty.⁸⁶

⁸¹ Cf. Michael Best, "Political power and tax revenues in Central America", *Journal of Development Economics*, No 3, 1976; Fernando E. Naranjo Villalobos, *A Macroeconometric Model of Fiscal Policy for Costa Rica*, a publication of the Universidad de Costa Rica, Degree Theses Series, No 21, 1974; Federico J. Herschel and M. Brodersohn, *Estímulo a la inversión industrial mediante incentivos tributarios en la Argentina*, *op. cit.*

⁸² This is the aspect examined in the United States (sector comprising corporations and other enterprises). See *Public Expenditure and Taxation*, *op. cit.*, p. 27.

⁸³ See M. Brodersohn "La política tributaria en cuanto determinante del nivel y estructura de las inversiones", *La política tributaria como instrumento del desarrollo*, *op. cit.*, p. 469. See also general report in *Tax Incentives . . .*, *op. cit.*, p. 30 *et seq.*

⁸⁴ Strictly speaking, there are, of course, differences between allocation and development, but it should be borne in mind that the system was originally intended for developed countries. See Federico J. Herschel, *Ensayos . . .*, *op. cit.*, pp. 24-39.

⁸⁵ See Marshall Wolfe, *El desarrollo equivocado . . .*, *op. cit.*

⁸⁶ See Aníbal Pinto, "Styles of development in Latin America", *op. cit.*, pp. 121-130.

Priority for redistribution is justified on the grounds that otherwise an increasingly extensive production structure is created, depending upon the development model chosen, which will make it more and more difficult to achieve a redistribution of income.

As far as possible, of course, the two objectives would have to be pursued simultaneously, but contradictions may arise between 'development' and 'distribution'. Two extreme attitudes towards this eventuality have been adopted: some refuse to recognize it on the score that an improvement in income distribution broadens the market, a requirement for boosting investment; while others maintain that the rich have a greater propensity to save, which likewise is a necessary condition for investment. This seems a somewhat fruitless discussion on the whole; what does appear needful is to underline two points:

(i) The possibility of conflict certainly exists; if a given supply of resources is available for the domestic market, to earmark a specific proportion for the production of capital goods is not the same thing as to do so for wage goods;

(ii) As noted earlier, the style of development will differ greatly according to the importance attributed to the improvement of income distribution, since both supply and demand depend on it.

From a more specific standpoint, and thinking of Latin America and its problems, it is believed, for example, that there are several countries which could eliminate or substantially relieve critical poverty within a reasonable period of time, without its necessarily entailing a total transformation of the existing system, although this would, of course, have to undergo considerable changes in its structure and operation.

In face of frequent optimism with respect to the potentialities of a fiscal policy encouraging private investment, and considerable pessimism as regards the achievement of redistribution objectives—or at any rate the elimination of relative poverty within a reasonable period—an opposite position has been taken up in this study. What is asserted here is that a stronger critical sense or even a measure of scepticism is necessary with respect to incentives, and greater optimism as regards the conceptual and practical possibilities of applying a redistribution policy. For the time being, of course, socio-political factors are not being taken into consideration. In other words, the assumption is that, in principle, it is neither difficult nor impossible to build schools or maintain medical services in the poorer areas of rural sectors.

Accordingly—and still leaving political restrictions out of account—it would be a matter of stepping up expenditure on education and public health. Although some studies showed that part of this expenditure (especially the outlays for higher education) did not basically benefit the lower income groups, particularly in rural areas,⁸⁷ it is maintained that this is not bound to happen, although greater coverage of the respective services may mean a proportionally higher cost. Moreover, a relative optimism is warranted inasmuch as the advances made in these fields are essentially the result of the public expenditure effected.⁸⁸

⁸⁷ Cf. Vito Tanzi, *Taxation, Educational Expenditure, and Income Distribution* (mimeographed text), especially p. 13.

⁸⁸ Cf. *Long-term trends and projections. . .*, *op. cit.* As a note of warning, from the point of view expressed here, it is stated that "the redistributive effects of these policies (in the

Table 4
**CHANGE IN THE MAGNITUDE AND STRUCTURE OF PUBLIC EXPENDITURE.
 RELATIONSHIP BETWEEN PUBLIC EXPENDITURE CLASSIFIED BY
 USE AND THE GROSS DOMESTIC PRODUCT**

(Percentages of the gross domestic product)

	<i>Structure</i>		<i>Difference between (1) and (2)</i>
	<i>Existing</i>	<i>Recommended (1980)</i>	
	<i>(1)</i>	<i>(2)</i>	<i>(3)</i>
<i>Total</i>	18	20	+2
Administrative and other expenditure of general benefit	6	5	-1
Economic	7	8	+1
Social	5	7	+2

Even if—in accordance with the proposed scheme of reform—more importance were given to social expenditure, spending on economic development would not cease. Table 4 shows the changes envisaged in the light of an estimate of variations in expenditure, based on a structure of expenditure considered typical for countries at an intermediate stage of development in Latin America.

Correlatively with the real increase in expenditure there would have to be a rise in real tax revenue.⁸⁹ This would require a tax reform that in essence would contemplate the following measures:

fields of education and health) lost some of their importance as the demands of economic growth led to a shift in emphasis in public expenditure to investment in material production sectors, at the expense of those services" (p. 7).

(A) Changes to improve the distribution of income (i.e., to make the tax system more progressive):

(i) The personal components of income tax would be strengthened. This end would be served in the following ways:

(1) By raising the rates, up to a marginal rate of 50 per cent for the highest income;

(2) By eliminating or reducing deductions, exemptions, etc., i.e., by attempting gradually to suppress what in the United States have been termed tax expenditures, a step that would simplify the system;

⁸⁹ This initial assumption implies that originally there was no deficit considered detrimental to the economy. The budget is not assumed to be totally balanced, since the countries tolerate a certain degree of financing by domestic and external credit.

(3) By eliminating deductions or exemptions except for specific sectors, as will be indicated later on;

(ii) The corporate tax would not be eliminated so as not to facilitate tax evasion. The following action would be taken in this field:

(1) The establishment, if none already exists, of a proportional tax on the income of corporations. For other types of association a proportional tax is not justified. Therefore, if any special tax exists on business associations of other types, it should be progressively eliminated and the profits obtained included in personal income tax;

(2) The elimination of dividends on bearer shares for tax purposes by means of the following measures:

(a) The total elimination of bearer shares in the corresponding codes;

(b) Payment of the maximum marginal rate of personal income tax on the distribution of dividends in the form of bearer shares;

(iii) In order to prevent evasion of income tax by manoeuvres designed to represent regular income as capital gains, and to levy tax on an obvious manifestation of capacity to contribute, a capital gains tax would be created which would subsequently be consolidated with income tax, due account being taken of the special characteristic of capital gains—realization in one year of the gains obtained over a longer period—, by means of an adequate system (for example, averaging):

(iv) The taxes on net wealth or parts thereof would be strengthened:

(1) The valuation of the assets concerned (for example, immovables) would be reviewed and updated;

(2) A personal net wealth tax would be created, which would also

call for the elimination of bearer shares in much the same manner as above;

(3) Within the net wealth tax a higher rate would be applied to those components represented by unproductive capital such as motor-cars, aircraft and yachts for personal use, gardens and parks, swimming-pools, etc.;

(4) An attempt would be made to give more importance to the tax on inheritance and donations. Taxes substituted for inheritance taxes would therefore, be eliminated and the old system would be resumed;

(v) The rates and scope of taxes on non-essential or luxury consumer goods would be increased, a policy which would need to be supplemented by other State action for reallocating the factors of production;

(vi) Taxation on consumption (sales and other taxes) would be eliminated in the case of essential goods and services;

(vii) Gradually, as the larger revenues resulting from these changes warranted it, the tax on popular-type cigarettes and alcoholic beverages could be reduced;

(viii) Personal contributions to the social security systems would be lessened. The reduction of revenue resulting from this measure would be covered by the increase in revenue accruing from the preceding changes, and if this were not enough, by a sales tax of a neutral or progressive character as regards its effect on income distribution.

The above recommendations need no further explanation, except that the essential reason for the greater emphasis on personal taxes is that this will make the system more equitable, and, moreover, there is less chance of the tax being transferred than in the case of the corporate tax.

(ix) More vigorous action would be taken to prevent evasion, to which end the following measures would be required:

(1) The penalties would be more severe;

(2) The resources earmarked for detecting tax evasion would be increased;

(3) The payments of the different taxes made by the various economic sectors would be investigated in order to quantify evasion and, in particular, to discover the areas where it was greatest.⁹⁰

(B) Action to promote economic development would be taken through the measures listed below, with due regard to the fact that the changes introduced would be essentially dependent on the stage of development already reached and on the requirements of the development plan. The aim would be to relate fiscal action closely to the concrete objectives of the plan, as regards both global targets and more specific goals, such as changes envisaged in the structure of production and in the possible choice of production techniques (consideration would be given here not only to the necessity of participating in technological progress but also to the desirability of using labour-intensive techniques). It should be noted, in this connexion, that on the whole fiscal reforms, and particularly tax reforms, have not been really related to the needs of the development strategy adopted in each case.⁹¹

⁹⁰ With respect to the quantification of evasion, see Federico J. Herschel, *Ensayos...*, *op. cit.*, pp. 194-198 and 256-274.

⁹¹ For a noteworthy effort to relate fiscal policy with development requirements, see CEPAL, "Las tareas de la política fiscal y

(x) Extensive use would be made of import and export taxes. Their specific nature would depend on each case, but by way of example the following measures may be mentioned:

(1) Import duties would be heavier on goods corresponding to more advanced stages of processing, e.g., intermediate and capital goods;

(2) Import duties (or similar taxes) would be gradually lowered on goods which already have a considerable period of domestic production behind them, with a view to bringing their prices more into line with international levels (both the duty rates and the tempo of liberalization would depend on the stage of development already reached by each branch or sector, and on its technological complexity);

(3) Favourable treatment would be given to industrial exports, and they would be exempted from internal taxation. Special incentives would be given to those incorporating a high proportion of domestic value added and some degree of advanced technology;

(xi) The elimination or reduction of taxes on investment in some high-priority branches of industry would be established or maintained in consonance with the development plan, always provided that the said activities were not in the hands of the State itself;

tributaria a la luz de los problemas del desarrollo de América Latina", *Ensayos de política fiscal, op. cit.* Although the approach is different, since the study deals with a developed country, tax changes are likewise related to development in *Report of the Royal Commission on Taxation*, vol. 2, Ottawa, Queen's Printer, 1966.

Of course, it is frequently pointed out that fiscal reform should "adapt its structure to development aims and the objectives of the plan" (see *Long-term trends and projections...*, *op. cit.*, p. 72).

(xii) If necessary, use would also be made of indirect taxes (on consumption and sales) to influence the assignment of resources. Even in a developed country such as the Federal Republic of Germany, locally-produced coal is subsidized while imported petroleum is taxed.⁹²

In table 5, tax changes are shown in relation to the gross domestic product.

No claim is made that the foregoing scheme introduces a complete innovation in the field of fiscal reform, but it is thought to be a possible point of departure.⁹³ The figures can therefore, change according to the stage of economic development reached, the existing fiscal structure and the scale of critical poverty.⁹⁴

⁹² Cf. Horst Claus Recktenwald, *Tax Incidence and Income Distribution*, Detroit, Wayne State University Press, 1971, p. 98.

⁹³ The thorny topic of foreign capital has not been discussed. In this connexion the following are considered the essential points: (a) no privileges of any kind should be accorded to foreign capital; (b) there should be a certain minimum control over the outflow of funds so that remittances of profits abroad may not be used to avoid or reduce the payment of income tax by nationals.

As regards innovations, a number of interesting ideas exist, but in the main they have not been tried out or, in practice, have proved unsuccessful. Cases in point are the tax on expenditure, which is no longer new; the tax on the brain drain; and the tax on unutilized capacity. (Cf. N. Kaldor, *An Expenditure Tax*, London, George Allen and Unwin, 1955; Sijbren Cnossen, "Capacity taxation: The Pakistan experiment", *Staff Papers*, vol. XXI, March 1974; Jagdish N. Bhagwati, "Taxing the brain drain", *Challenge*, July-August 1976, pp. 34-38).

⁹⁴ In *Long-term trends and projections...*, *op. cit.*, p. 16, an estimate of the population with incomes below the cost of a minimum balanced diet was prepared for nine Latin American countries. For these countries in the

The approach to the changes hitherto recommended has been economic, with emphasis on social development, not taking into account the fact that "the social classes, power relations and the political nature of the State are of fundamental importance in the orientation of development strategies".⁹⁵

An attempt has been made to relate the standard calculations of the fiscal system with the class structure existing in most of the Latin American countries, as the controversial idea of neutral techniques⁹⁶ is not shared here, while the need to overcome segmentation of disciplines is recognized. This essay represents an extremely modest venture into sciences other than economics, with the basic purpose of opening a dialogue with sociologists and politologists so that they may criticize and/or study in greater depth the rough ideas submitted for comment. In any event, something more is offered than an approach divorced from reality and advising programmes of reform to governments "whose *raison d'être* is precisely the prevention of such developments, or at least limiting them to the greatest extent possible".⁹⁷ A specific attempt has been made in table 6 to answer the following question: Who

aggregate the population living in such extreme poverty was calculated at 35 per cent of the total, the individual figures ranging between 11 and 49 per cent.

⁹⁵ Jorge Graciarena, "Power and development styles", *CEPAL Review*, first half of 1976, p. 173.

⁹⁶ Cf. Marshall Wolfe, "Approaches to development: Who is approaching what?", *CEPAL Review*, N° 1, first half of 1976, p. 131.

⁹⁷ Cf. Dudley Seers, "The prevalence of pseudo-planning", in *The Crisis in Planning* (ed. Mike Faber and Dudley Seers), London, Chatto and Windus for Sussex University Press, 1972, quoted by M. Wolfe in "Approaches to development..."; *op. cit.*, p. 141.

Table 5
**TAX REVENUE: RELATION OF EACH INDIVIDUAL TAX AND THE
 TOTAL TO THE GROSS DOMESTIC PRODUCT**

(Percentages of GDP)

	<i>Structure</i>		<i>Difference between (1) and (2)</i>
	<i>Existing</i>	<i>Recommended (1980)</i>	
	<i>(1)</i>	<i>(2)</i>	
Total tax burden/GDP	18.00	20.00	—
Taxes			
On exports	1.00	1.00	—
On imports	6.00	5.00	-1.00
On income	2.50	5.00	+2.50
Personal	1.00	3.00	2.00
Corporate	1.50	2.00	0.50
Social security contributions	2.00	1.00	-1.00
Sales tax	2.50	3.00	+0.50
Selective tax on consumption	2.50	2.00	-0.50
Tax on net wealth or components thereof	0.50	2.00	+1.50
Other taxes	1.00	1.00	—

gains and who loses?⁹⁸ Four social groups or classes are identified for the purpose.⁹⁹

Table 6 shows the social classes that do or do not benefit by increases and reductions in expenditure and taxes. The following explanation of this scheme may be given: an increase in taxes is considered to mean a reduction in income and an increase in expenditure with greater benefits received.

The change in the structure of import taxes would consist in a reduction of protectionist duties on such final consumer goods as represent consumption by the lower income strata (urban and rural workers). In the entrepreneurial sector an intra-sectoral change would take place in favour of those manufacturing products with a more complex structure, which would initially be prejudicial to producers of final consumer goods (durables and particularly non-durables).¹⁰⁰

⁹⁸ Cf. J. Graciarena, "Power and development styles", *op. cit.*

⁹⁹ For interesting background data, see Michael Best, "Political power and tax revenues in Central America", *Journal of Development Economics*, N° 3, 1976, pp. 49-82; and Harley H. Hinrichs, "Tax reform constrained by fiscal harmonization within common markets: Growth without development in Guatemala", *Fiscal Policy for Industrialization and Development in Latin America* (ed. David T. Geithman), Gainesville, The University of Florida Press, 1974.

¹⁰⁰ The scheme used does not adequately represent the benefit deriving from higher protectionist taxation. This case is not considered in the table so as to preserve the balance of the scheme. To account for the figure in favour of entrepreneurs, it could be assumed to represent a reduction in taxes on the capital goods and inputs required by entrepreneurs producing goods of this same kind.

The income tax figures incorporate the changes recommended (strengthening of personal tax, heavier taxation on the agricultural sector—possibly through a tax on presumed income—the creation of a capital gains tax and a reduction of exemptions).

The reduction in personal contributions to the social security system would benefit the workers. The increase in income tax, for its part, would be based on a criterion of progressiveness, so that it would have a greater impact on the high-income groups (entrepreneurs and landowners). A similar principle would be followed in introducing changes in the structure of selective taxes, lower taxation on essential consumption and higher taxation on non-essential or luxury goods. Taxes on net wealth, for their part, would affect persons with high incomes, particularly in the land-owning sector.

On the other hand, the distribution of expenditure is perfectly clear: economic expenditure benefits the entrepreneurial sector, social expenditure the needier groups, particularly in the rural area, and expenditure for administrative purposes or of general benefit favours the population groups in proportion to their income.¹⁰¹

The last item shows the total advantages or disadvantages affecting each group owing to the combined action of taxes and expenditure. Another point observable here is that this budget, which in line with the Musgrave model would be essentially redistributive, is balanced, i.e., the benefits obtained by

¹⁰¹ The commonest procedure for distributing this kind of expenditure has been followed here, although to a certain extent it may seem surprising that expenditure of this type implies a benefit.

Table 6
**CHANGES IN TAXES, EXPENDITURE, AND THEIR IMPACT ON THE
 SOCIAL CLASSES AND THE GOVERNMENT**
(Percentages of gross domestic product)

	<i>Government</i>	<i>Working class</i>	<i>Entrepreneurs</i>	<i>Land-owners</i>	<i>Rural population</i>
<i>Total</i>		+2.45	-1.50	-3.60	+2.65
Taxes	+2.00	+2.15	-2.20	-3.20	+1.25
On exports	-	-	-	-	-
On imports	-1.00	+0.25	+0.50	-	+0.25
On income	+2.50	-	-	-	-
Personal	-	-	-0.50	-1.50	-
Corporate	-	-	-0.50	-	-
Social security contributions	-1.00	+1.00	-	-	-
Sales taxes	+0.50	-0.10	+0.20	-0.20	-
Specific taxes on consumption	-0.50	+1.00	-1.00	-0.50	+1.00
Tax on net wealth or components thereof	+1.50	-	-0.50	-1.00	-
Other taxes	-	-	-	-	-
Expenditure	+2.00	+0.30	+0.70	-0.40	+1.40
Administrative	-1.00	-0.20	-0.30	-0.40	-0.10
Economic	+1.00	-	+1.00	-	-
Social	+2.00	+0.50	-	-	+1.50

Note: For the private sector:

Under taxes:

+ = reduction in taxes

- = increase in taxes

Under expenditure:

- = reduction in expenditure (benefit)

+ = increase in expenditure

some groups have to be paid for by others.

The sectors thus benefiting are basically the rural and urban workers. Most of the cost would be paid by the landowners and, to a lesser extent, by the entrepreneurial sectors. As regards the latter, it must be borne in mind that table 6 shows the aggregate burden, but in view of the above-mentioned structural changes there may be a sub-group which will benefit. Moreover, it should be taken into account that the purchases made by the public sector (in relation to

economic and social expenditure, excluding the payment of wages) can also benefit entrepreneurial sub-groups. In short, the landowning sector is powerfully affected, and so –albeit to a lesser degree– is part of the entrepreneurial sector.

By way of considering the foregoing scheme in terms of reality, an attempt has been made to link it with the possible policies of populist movements. In spite of the marked differences between reformism and populism, the proposed system is held, in principle, to be applicable to both movements.¹⁰²

¹⁰² Torcuato S. di Tella, whose typification is used, expressly states that the dividing line is somewhat blurred; the reformist party is a workers' party which receives only minor assistance from the middle classes and intellectuals. In any case assistance or tolerance is accorded by other groups, so that the basic characteristics indicated by di Tella are believed to be applicable to reformism too. The scheme is as follows:

**CHARACTERISTICS OF POPULIST MOVEMENTS (IN DEVELOPING COUNTRIES)
BY TYPES OF GROUPS OTHER THAN THE WORKING CLASSES**

	<i>Includes groups legitimized within their class</i>	<i>Includes groups illegitimized within their class</i>
	1	2
Includes elements of the bourgeoisie, the army or the clergy (apart from the lower strata)	This is the most moderate alternative. It can easily lose its populist character and become conservative	Intermediate alternative, marked by a strong tendency to use violent methods, but acceptance of the more basic values of the existing social order
	3	4
Includes only elements of the lower middle classes or intellectuals (apart from the working classes)	Intermediate alternative, characterized by a tendency to use legal methods, but fairly radical criticism of the basic values of the existing social order	The most radical alternative. Oriented towards a social revolution that would alter the basic pattern of property ownership

Source: Torcuato S. di Tella, "Populismo y reformismo", in Gino Germani, Torcuato S. di Tella and Octavio Ianni, *Populismo y contradicciones de clase en Latinoamérica*.

The programmes of fiscal reforms suggested would correspond to situations which T. di Tella calls 'intermediate' i.e., lacking support from the legitimized groups of the bourgeoisie, the army or the clergy.¹⁰³

So extensive a commentary on the outline of a programme which is likely to be put into practice only in exceptional cases will probably be queried.

What must be said in reply, apart from the observations made earlier, is that most countries know how to carry out a fiscal policy without redistribution and sometimes without economic development either. Should there be any doubt on the subject, history books dealing with the times of Louis XIV or Marie Antoinette could teach some interesting lessons.

¹⁰³ See *Populismo y Reformismo, op. cit.* Under the previous system the "reforms" com-

mented on here could be carried out in cases 2 and 3, particularly the latter.